POLISH DEBT

HEARING

BEFORE THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

TO DISCUSS POLISH DEBT IN THE FRAMEWORK OF U.S. OVERALL POLICIES TOWARD POLAND, EASTERN EUROPE, AND THE SOVIET UNION

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POLISH DEBT

TUESDAY, FEBRUARY 23, 1982

U.S. Senate,
Committee on Banking, Housing, and Urban Affairs,
Washington, D.C.

The committee met at 9:30 a.m., in room 5302, Dirksen Senate Office Building, Senator Jake Garn (chairman of the committee) presiding.

Present: Senators Garn, Heinz, and Proxmire.

Also present: Senators Daniel Patrick Moynihan and Robert W. Kasten.

OPENING STATEMENT OF CHAIRMAN GARN

The Chairman. The Banking Committee will come to order.

In the early 1970's the United States and its allies began a policy of easing tensions with the Soviet bloc. That policy has become unraveled by Soviet double-dealing and adventurism, and by the failure of our NATO allies to respond to the dangers of Soviet policies. Heavy Soviet military buildups, financed by Western capital and made possible by Western technology, bought or stolen by the Soviet Union and its allies, are now coupled with economic manipulation designed to divide and neutralize our European allies. However abysmal NATO's response to the Soviet military buildup has been, our defense against the economic dangers has been worse.

Nowhere has this been more obvious than in the West's reaction to events in Poland. While the Soviets and their surrogates have methodically and ever more brutally repressed freedom in Poland, NATO has responded with little more than arid denunciations. Beyond all understanding, in the face of blatant repression in their own back yard, the Western Europeans have joined with Moscow in the preparation and financing of a natural gas pipeline that is essential for the Soviet Union to maintain its heavy armament programs and save its economy from severe dislocation and which will make the Western European democracies dependent for their natural gas supplies on the power that is squashing democratic reforms in Poland.

The Western European delusion of being able to continue to pursue a separate détente with the East while the United States foots the defense bill cannot continue. The American people must not be made to suffer the hardships of trade embargoes while the Europeans trade willy-nilly with the Soviets.

I am not opposed to all trade with the Soviet bloc, but that trade must be closely circumscribed by political considerations and objectives. Trade offers us great opportunities. The Communist systems are simply no match for the West in an economic competition. Yet thus far the West has been the economic loser, because we have failed to use trade to our advantage. Nor have we used the weapon of capital effectively. With the current disunity in the Western alliance, it is an open question as to which side has the most leverage from the current $73 billion debt owed by the East to the West. Currently, we in the West seem more nervous about it than they in the East do.

The export performance of the Soviet bloc economies has been no better than that of the less developed countries. That should give the West tremendous leverage. Yet we seem paralyzed and unable to press our advantage to any political gain.

Today's hearing is intended to examine that leverage as it applies to Poland. But this hearing involves more than Poland, for events there will affect the whole network of East-West relations. It is here that the entire past 10 years of these relations are being put to the test. The issue is Polish debt, but the questions involved are far from being only, or even predominantly, economic. Will the West show continued demoralization, or will it show a regeneration of determination to resist Soviet imperialism? Can we force the Soviets to face the consequences of the contradictions and inadequacies of their economic, social, and political system, or will we continue to supply them with what they need to patch over their problems? The issue is clearly bankruptcy, but what bankruptcy will be shown? The bankruptcy of the Soviet system, or the bankruptcy of the NATO alliance?

Many voices have called for a default of the huge Polish debt. That may be just a mere semantic issue; the inability of Poland to meet its obligations is obvious, and neither the continuation of the military government nor sales of billions of dollars more of Soviet gold will be enough to meet those obligations.

I have no preconceived notions on the question, other than the conviction that the West must—and I am convinced can—use its economic leverage to effect change in Poland. That may be through default or through some other means of managing the Polish debt while applying power as constantly and relentlessly as the Soviets and their accomplices are applying it in Poland. I am open on the question. As I promised on the floor of the Senate, these hearings will examine the whole complicated issue. We have excellent witnesses today, and I am looking forward to the testimony that will be given.

The West must respond forcefully and clearly to the situation. Our response must be unified, though it is clear that a unified NATO will be impossible without American leadership. In Poland, Lech Walesa must be released. The military repression must stop. The process of reform must be allowed to continue. It is my hope that our witnesses can point the way toward the achievement of those objectives.

Senator Heinz, do you have an opening statement?

Senator HEINZ. I do, Mr. Chairman. I would like to put the entire statement in the record but abbreviate the few remarks I have.

First of all, I do want to thank you for calling these hearings. We have a distinguished panel of witnesses today. One of them, Felix Rohatyn, observed in a recent article that the weapon of capital is potentially one of the most powerful and the least used in the Western World. Poland does indeed give us a chance to use this leverage to bring about change in the Soviet Union and her satellites, and as the Soviets watch their economic system slowly grinding to a halt I think they too are coming to the same realization.

It was Mao Tse Tung who observed that power grows out of the barrel of a gun, political power, and that certainly has been the Communist practice, of which the latest repression in Poland is only part of a continuing series of demonstrations. But beyond demonstrating the moral and philosophical and ideological bankruptcy of the Soviet system of repression, it is economically disastrous as well. Tanks can get workers into the factory but they can't make those workers produce.

And so the Polish crisis presents this country with a great opportunity. The question, it seems to me, is not whether the West should use its leverage to influence affairs in Poland; the only question is how? Some have called for a unilateral declaration of default by the United States. That strategy would have the virtue of demonstrating the bankruptcy of communism in Eastern Europe. It might also provide us with the leverage we need to affect the course of future policy within Poland.

We are also aware that others have said that a unilateral declaration by the United States of that default would merely play into the hands of the Soviets. They argue that would expose the disarray in the Western alliance.

I hope this hearing, Mr. Chairman, can settle some of those questions today. I join you in your statement of the fundamental goals of which we must not lose sight. I, too, believe that the goals are that Lech Walesa must be released, that the suppression and brutality against Solidarity must cease, that martial law must come to an end. I don't believe we have to prescribe each step of the way toward democratic reforms and human rights, but those reforms must be regarded as the prerequisite to any sort of Western credit or beginnings toward normalization. In short, we must learn to use the leverage inherent in the credit needs of the East to our advantage.

It is my hope that today's hearing will be perhaps the most significant hearings ever held on how we may use this leverage. It is no secret that Poland owes the Western nations and banks $26 billion. There is ample evidence that will be further documented today that they must turn to the West for between $15 and $20 billion of additional credit over the next 2, 3 or 4 years. That's on top of the $26 billion which they cannot now repay. If there was ever a time for this country to think of how to use that leverage—for example, to compel the Soviets to move forward not only on human rights in the Eastern bloc but toward arms control—this would seem like one of the best chances of our generation.

Thank you, Mr. Chairman.

[Complete statement follows as though read:]

OPENING STATEMENT OF SENATOR HEINZ

Senator **Heinz**. I want to thank Senator Garn for calling this hearing. We certainly have a distinguished panel of witnesses. One of those witnesses, Felix Rohatyn, made a statement in a recent article that sums up well the purpose of this hearing: "The weapon of capital is potentially one of the most powerful and least used in the Western World. Poland affords us a chance to use it. It might be our only effective way, in the long run, of bringing about change behind the Iron Curtain." I believe that, and I think that the Soviets believe that, as they watch their economic system slowly grinding to a halt.

Mao Tse Tung claimed that political power grows out of the barrel of a gun. That certainly has been the Communist practice, of which the latest repression in Poland is only part of a continuing series. Not only is that morally reprehensible; it makes lousy economics as well. Tanks may get workers into the factories, but they haven't been able to make them produce.

The Polish crisis presents the United States with great opportunities for the realization of our national ideals along with dangerous challenges to the preservation of those ideals. Along with the hope of freedom lurks the despair of repression. With the opportunity for allied action comes the threat of allied disarray. We may find a way to exercise economic leverage for the renewal of liberalization in Poland and to curb Soviet adventurism, or we may be paralyzed by indecision while Solidarity is crushed and the Western alliance disintegrates in a scramble to finance for the Soviets what they can't finance for themselves.

There will be no economic revival in Poland without political reform. And without political reform, the living conditions of the Polish people will continue to spiral to the bottom. The lines to purchase nonexistent essentials with a worthless currency will continue to lengthen. Violent dissent will grow, matched by ever more ruthless repression.

The West did nothing while the Soviets crushed Hungary in 1956 and little more when they invaded Czechoslovakia in 1968. In neither of those cases, however, was the Soviet Union and its allies in such deep economic difficulties or so heavily dependent upon Western capital as they are today.

The question, it seems to me, is not whether the West should use its leverage to influence affairs in Poland; the question is how. Some have called for a unilateral declaration of default by the United States. That strategy would have the virtue of demonstrating the bankruptcy of communism in Eastern Europe. It might also provide us with the leverage we need to affect the course of future policy within Poland.

Others have said that unilateral default by the United States would merely play into the hands of the Soviets. They argue that it would expose the disarray in the Western alliance while freeing the current Polish regime from the obligation to pay its debts to us.

The debate goes on, and that is why this hearing should prove to be valuable in clarifying the costs and benefits of the options open to our Government. It is clear, however, that whatever strategy we ultimately choose, there are certain fundamental goals of which we must not lose sight.

Lech Walesa must be released. The suppression and brutality against Solidarity must cease. Martial law must come to an end. We need not prescribe each step of the way toward democratic reforms and human rights, but those reforms must be regarded as the prerequisite to any sort of Western credit or beginnings toward normalization.

We must learn to use the leverage inherent in the credit needs of the East to our advantage. Beyond the immediate situation in Poland, arms control stands as the greatest problem we face. There is no reason why we should keep those two issues isolated from one another. Why not make genuine progress toward arms reduction one of the factors on the extension of credit to the East?

In the immediate future, however, we in the West must not desert the Polish people to fend for themselves against a military government backed by dozens of Soviet divisions just across the border. We must use our economic leverage to best advantage to reverse the brutal trend of the past 2 months. It is my hope that this hearing will help to clarify the issue and point the way toward the best strategy to achieve the goal of freedom and enjoyment of human rights for Poland we all desire.

The **CHAIRMAN**. Thank you, Senator Heinz.

Mr. Ambassador, we are honored to have you with us today. This committee has great admiration for you and the courage that you have displayed in support of your country and the movement for freedom within Poland. So we are very honored that you would be with us today to testify and we will be happy to hear from you at this time.

STATEMENT OF ZDZISLAW RURARZ, FORMER POLISH AMBASSADOR TO JAPAN

Dr. **RURARZ**. I thank you very much, Mr. Chairman and I feel very privileged to address your committee on the problem which is the Polish debt and how to handle it.

Since I have been given a chance of speaking without a prepared text, a prearranged text, I will be reacting to certain of the views which I read just before entering the room, and may I add that I fully share those views which have been expressed in this room by Mr. Rohatyn, so I will probably not repeat some of his arguments, but I would just like to state that I fully share them.

NO ECONOMIC REFORM POSSIBLE

Now let me only supplement some of his remarks and the remarks which I would have presented to you anyway. I must say that I have been very closely associated with the Polish economy. That from September 1971 until the end of 1972 I was Gierek's economic adviser, the only one at that time. I have resigned and it was precisely on the economic issues. It was for me sure that when we were opening to the West to ask for the credits and technology that we had to reform our economy to the extent that we would be in a position in the future to service the growing debt. Unfortunately, at that time no economic reform was possible. May I state in this room what I have already said to the New York Times which interviewed me, that when I prepared the draft of the economic reform and I presented it to Mr. Gierek, he, after reading it, told me, "No reform." I was insisting to know why that reform was impossible.

May I just say that the proposals that I was making was a reform of a sort of a market economy and besides I was giving much more emphasis on private farming and the private business in general, including the admission of foreign private capital to the Polish economy and direct investments, and he told me at that time that this was absolutely impossible. Then he added, "If we were only alone," meaning that certainly the U.S.S.R. would never accept any sort of such economic reform.

Afterward, I went to Moscow. I spoke for several hours at the Central Committee of the Soviet Communist Party and I left that building with the impression that not the slightest concession would be made to us when it comes to the reform of this sort I was proposing. Therefore, I resigned. I resigned almost immediately after that talk in Moscow in February 1972, but it took me several months before I left. So it was not true what Mr. Rakowski is saying that I was not protesting in the past in his interview with Oriana Fallaci. I was absolutely sure that sooner or later the Polish economy would go bankrupt and certainly this was the case. It is, of course, absolutely untrue that all the economic difficulties caused in Poland were of Gierek's making, neither of Soldarity's.

May I say that in 1979 which was before Solidarity was established, the GNP fell 2.5 percent and afterwards, of course, there was a downtrend in our economy.

Now when it comes to Poland's ability to handle the debt, I have left many things behind but one document I have here in Washington in Polish. I can present it to the committee if you would like. It refers to the issue of Poland's debt. I delivered it to the Polish Government which at that time was presenting to the so-called Paris Group its position on the said debt. I brought a document prepared by the Government from Poland last June when I was in Warsaw and I read it very carefully. I learned from that document that Poland was saying to some Western governments in the Paris Group that the amount of that debt should reach probably something like $32 to $35 billion and only afterwards Poland would start reducing the level of it. So that even under the best of conditions the debt of Poland was supposed to grow from the present level of something like $26 billion excluding the Soviet debt, to maybe $35 billion. Thus rescheduling and new credits were supposed to be forthcoming.

PROBABLE DEBT OF $50 BILLION

I studied that document very carefully and I was highly critical of it and my views I prepared in a written form. I have that document here in Washington. I told in Warsaw several top leaders of Poland that this is certainly a wrong calculation and that the level of the Polish debt should probably reach no less than $50 billion by the year of 1985, and only probably afterwards would that level stabilize with the possibility of being reduced. There was no reaction to that paper by me and now I think that I would stick even more to my paper. I believe that even $50 billion probably would not settle Poland's problem.

What is this problem? Well, Senator, I might say this. Poland's economic strategy in the 1970's was growth without changing the functioning of the system, that is, to invest as much as possible, relying very much on foreign debt and foreign technology to this end. There was no clear program of what these investments could really do and when and at what cost. I must say that there was a great deal of improvisation here and that in fact nobody had any control over those investments and over those debts. So the investments which were going into the Polish economy, as was always the case not only in Poland but also in other Eastern European countries, were going out of hand. Always it was the losing of the control over the level and the cost of investments. The same situation is being repeated at this time but on a much bigger scale. It is difficult to calculate in terms of dollars how much of those investments are completely canceled or postponed for an indefinite period or somehow rearranged. My guess would be that in terms of dollars, all those investments could be somewhere around $50 billion and since the Polish GNP is probably no more than $100 billion, you have the picture of the situation by how much the Polish economy has been overburdened by these misinvestments.

There was a great hope in Poland, at least when it comes to the Government, that these massive investments will bring about the so-called "investment crops" in the future. May I forcefully state that there will be no "investment crops" in Poland. It is out of the question. So that any chance of repaying those invested money from the past is, of course, having no slightest chance. The Polish economy is not prepared to service the debt.

Now let me say a few details. When it comes to the ability of Poland to export to the Western countries, it was supposed, in that document which was presented to the so-called Paris Group, that those exports could be rising very fast, sometimes even 15 percent a year in constant prices. This is quite simply a lie, Senator. Poland is not in a position to increase exports at this rate. Moreover, I think Poland is not even in a position to maintain the level of exports to the West which it had prior to the military crackdown or prior to the events in Poland. Those exports are mainly composed of coal and food products.

When it comes to coal, the production of it has dropped since 1979. There is some chance that it may rise a bit due to the forced labor in the coal mines and to the extended work week, but not very much and will not reach 1979 level. I don't think that the level of coal exports to the Western countries can reach that level of 1979 that is some 22 million tons of coal. But even if this was to be true, this 22 million tons of coal, this would be, according to the present prices, no more than $1.2 or $1.3 billion.

When it comes to food exports, which was the second major item in Poland's exports, at least to the West, right now even the military junta has abandoned the food exports totally and I cannot visualize how these exports would be restored. There's a great shortage of food in Poland.

When it comes to other products, I must say that those manufacturers which were supposed to be "the future of Poland's export to the West" are at least a big question mark. Right now the industrial production in Poland is falling. Even the new industries which have been building throughout the 1970's are now lacking spare parts and other components. And I'm not talking about the passive resistance of the workers and so on that affects the situation further on.

So virtually there is no chance for Poland to restore even the previous level of exports to the West, and not a chance of expanding these exports.

Now when it comes to the Polish credit needs and rescheduling, this is, according to my estimate, no less than something like $25 billion which Poland would be needing in the next few years. So that is the picture of the situation. Certainly in that paper in Warsaw I was proposing that the Polish Government go to the Western Governments to ask for understanding, to start renegotiations of our debt. What I was specifically proposing to ask that the Western Governments convert the public debt or the private debt but guaranteed by the Western Governments into private direct investments by the Western corporations which would, maybe, in this way be attracted to investing in Poland and to make the Polish economy function properly. So this was probably, according to me, the only way out.

POLISH ECONOMY BANKRUPT

Certainly this was never picked up and now, under the circumstances, I don't see that it will ever be. So that practically the Polish economy is absolutely bankrupt. There is no slight chance that it would be able to service the debt and continue to maintain the present standard of living or even to function as such. So that this is a bankruptcy without any possibility that it could be reversed by the Soviet Union.

I don't agree with any of the arguments which I sometimes read that the Soviet economy is willing or is capable of bailing out Poland from this mess. The Soviets do not have enough money for this. Their economy is also weak, it is stagnating. The Soviet economy cannot simply do this. Neither any other Eastern economy will do this. Soon there will be some other Eastern European economies that will be facing the same situation as Poland is at present. So this is something one should remember also.

Poland is practically in default already. It's only a question of a political decision by the United States and by other Western countries whether to say this publicly. From what I understand there are some arguments behind the thesis that this cannot be right now said, but I must say that if it is not said, then, of course, the question arises that somebody will have to finance the existence of the Polish economy and of some other Eastern European countries. Thus you have to face that reality.

Now as to whether this could be publicly or unofficially said to the Polish military junta? Certainly it could be. But I don't think it would present any results. That junta is subservient to the Soviet Union. Certainly it may listen to all the arguments, to all the proposals initiated by the Western Governments, but certainly it will decide nothing. It will refer this back to Moscow and Moscow certainly will be instigating the military junta not to surrender before any of the demands from the Western Governments.

ANNOUNCE PUBLICLY POLISH DEFAULT

So the problem is that you're at the crossroads and you have to do something. My advice would be just to say publicly what is already true technically, that Poland is in default. And you must be very firm on that. Otherwise somebody will be paying for bailing out the economy of Poland, and of other Eastern European countries one day, without any prospect that they would pay it off.

As to the problems in Poland, the social and political problems, they are because primarily of malfunctions of the socialist economy and I think that the best solution is to make a point of that, that if that economy is to continue to malfunction, let the people protest. Let the people revolt. That's the only possibility of a change in Poland and in Eastern Europe. Certainly this would be at a price, but I think there is no other way out.

But at the same time, I should like to state very forcefully that you have to do everything that is at your disposal that the Polish people, and not only the military junta, knows about it. May I say that the "Radio Liberty" and "Free Europe" broadcasts cost only $100 million annually, which is equal to one-third of B-1 bomber. Whereas the jamming of them costs the U.S.S.R. and Poland $300 million respectively. Nevertheless, it is worth increasing the beaming to Poland because this would also be a heavy burden on the Soviet Government and the Polish military junta and, at the same time, this would be penetrating the minds of the Polish people. I think Poland should be bailed out in case Poland would be independent and free. Then I believe very much that the Western Governments and Western business would help Poland to be bailed out of that mess. But under the situation where Poland is subjugated by a military junta where the basic human rights are denied to the Polish people, I don't think any help should be extended to the military junta and, of course, to the Soviet Union.

May I say this, in ending my introductory statement, that I know for sure because I was in that establishment that the establishment in Poland was always saying, "Let the creditors be worried about our debt". And because everybody is so afraid of bloodshed in Poland the establishment believes further that it will be helped somehow by the others so that the situation does not deteriorate to the extent that there would be a bloodshed and eventually a war in Europe. Thus that is the situation. So they believe that whatever they do, somehow they will be helped, bailed out; and therefore, this is discouraging them to do anything what would be proper.

When it comes to the Polish people, they are now highly suspicious of everything that is going on in Poland and around Poland. And since there is a great deal of a feeling in Poland that she has been abandoned in the past, and now if the West bails out the military junta the Polish people may believe again that something is going on behind the scenes, despite all the rhetoric in the West. That the West is trying to bail out the military junta from all the trouble, and this may be disarming morally and spiritually to the Polish people who must resist this military junta and who must bring it down.

Thank you very much.

The CHAIRMAN. Thank you, Mr. Ambassador. I certainly agree with you that Poland is already in technical default and they simply haven't called it that, but some who oppose default make the analogy of a company. If a company goes into default, its assets are divided up. There's something to seize. It doesn't continue to exist. But what I wonder is how default affects a sovereign state. Poland will continue. They don't just go belly up and cease to exist, and that is the argument that some have made in opposing the default, that there is nothing to seize. There's nothing the creditors can come in and take to provide for payment of some of that loan.

So how do you see that if we said that they were in default and called the loans. How would it affect the situation in Poland?

Dr. RURARZ. Well, my advice would be this, if I may say so, because if you do not declare Poland in default then, of course, you have to continue to provide her with the new credits somehow and reschedule the debt. At the same time, I understand naturally that there is really not very much to seize in case of default. Besides, any seizure of any of the Polish property could be misunderstood by the Polish nation which believes that everything is the property of the nation. I don't know whether from a purely legal point of view it is possible to declare the default without maybe trying to seize this or that particular ship or something like that. Anyway the Poles might not like that. Maybe only the Polish Il-62 passenger aircraft could not be deplored here when seized because it is a highly uneconomical aircraft, what is even making the economy situation in Poland more difficult if those planes fly. So maybe on that specifically I would be yielding and maybe I would recommend that you seize some of the aircraft. At the same time some sort of generosity could be shown to the Polish public that you are doing this or that and you are not doing this and that. Nevertheless you should be not giving the military junta any more help because that junta continues to be oppressive and it can be even more oppressive at any minute. Maybe there is not too much excessive brutality right now, but it can be changed any minute.

May I say this, how can the Polish economy function when the security policy costs more than the health, education, higher education, including technology, combined. The military junta is now spending even more on security forces. So this is a deep drain on the economy. I think that something like 12 percent of the Polish GNP is spent on defense and security. This is the state of affairs and the West should not be going to subsidize these debts and the Polish people should know why. There are the means of communication to that end. So I think that there is no other way out. The situation in Poland will remain difficult even with the CCC credits. Maybe the U.S. Government—I think maybe the lawyers—could find a way out so that default would be declared without certain drastic measures resulting therefrom.

And as you, Mr. Chairman, rightly said, somebody here must be a leader. If you're going to wait for the common agreement of the Western allies, I don't know whether that would be reached, but somebody must always be the leader. That's my understanding.

The CHAIRMAN. Mr. Ambassador, do you feel that if we did declare default that because there is so little to seize, as opposed to the normal situation where someone goes bankrupt, that it's more symbolic—it's more like sending a message to the Polish people that we do care, that we are going to take some action, even though that actual declaration would not do much more? Technically speaking, they already are in default, as you've said. So is it more of a political statement, a symbolic action, than the actual effect that it would have on the Polish economy?

Dr. **Rurarz**. Well, right now I think it is politically absolutely necessary. That's my understanding of the situation; that whatever means are at the disposal of the free countries, they should be used. I'm not preaching any war against the U.S.S.R. or the Polish military junta because I understand very well what the result would be, but what else is left here as a leverage? Why should you not declare Poland in default? I think some other Eastern European countries are just standing in the same line and they would also be in default very soon, maybe including the U.S.S.R. Let then the people press the military junta. Let the junta have the trouble. Because otherwise the military junta if helped may have a temporary success in calming down the population, in bringing about some sort of a temporary stabilization to the economy. And this would be going to the credit of the military junta, that is that the repressive measures are paying off.

I think this is a political decision for you and that political decision has a price certainly. And I think that somebody must pay that price. Otherwise, there would be prolongation of this agony in Poland. I don't know whether that agony will last a few years or a few months or maybe a few weeks. I'm very much afraid that the situation in Poland has deteriorated to the extent that almost anything can be expected and I think maybe this is even necessary. One cannot avoid the suffering of the Polish people but, at the same time, one cannot permit that system to function endlessly and be subsidized by the United States. So these are the crossroads.

The **Chairman**. Senator Proxmire.

Senator **Proxmire**. Ambassador, I apologize for being tardy. I have been informed that you have made a very excellent statement, a very interesting statement.

I'd like to ask you—you indicated that you made a recommendation to provide an economic reform and move toward a market economy with emphasis on private business and private capital, and then you were told that the Soviet Union would never permit that, would never accept it; and as I understand it, you found that out directly from the people in Russia in Moscow; is that correct?

Dr. **Rurarz**. Yes.

VIOLATION OF THE HELSINKI ACCORD

Senator **Proxmire**. Isn't that a direct violation of article VIII of the Helsinki accord which provides, and I quote,

> By virtue of the principles of legal rights and self-determination of all people, people always have the right and freedom to determine as they wish their internal political status without external influence and pursue as they wish their political, economic, social and cultural development.

Isn't that an explicit clear violation of that agreement to which the Soviet Union agreed?

Dr. Rurarz. Senator, at the time I was in Moscow, it was in February 1972, there was no Helsinki accord. But certainly what is now in Poland is in violation of the articles starting with the U.N. Charter and with the Helsinki accord ending.

Senator Proxmire. Now you added something I didn't understand before. You were in the Soviet Union before the Helsinki accord?

Dr. Rurarz. Yes.

Senator Proxmire. All right. That's a different situation. But I take it that the situation is still the same as far as the freedom of the Polish people to adopt the market economy. They cannot do it and their inability to do it does violate right now the Helsinki accord; is that right?

Dr. Rurarz. Exactly. Well, in the Soviet press I think in Izvistia after the Helsinki accord—and this was I think in 1980—there was a big article "Sorremichnyi Polak Kakov on?" Here was a very strong statement that most of Poland's economic problems were because of the private farming and because of some people trying certain ideas of how to decentralize the economy. So they continue this view and I think now even more than then.

Senator Proxmire. Then I take it also that you have indicated in your judgment that there's no way the Polish economy can service the debt or repay the debt; is that right?

Dr. Rurarz. Exactly.

Senator Proxmire. That debt is $25 or $26 billion?

Dr. Rurarz. Yes, $28 billion, including the credits from the U.S.S.R. and other Eastern European countries, but $26 billion from the West.

Senator Proxmire. Under those circumstances, normally the fact of default obviously can be recognized, and what are the consequences of that if we acted to precipitate default?

CONSEQUENCES OF DEFAULT

Dr. Rurarz. The consequences for Poland or for the Western world?

Senator Proxmire. Consequences for Poland and for the Western world.

Dr. Rurarz. For Poland, well, the economy certainly would deteriorate and mainly some industries which are heavily relying on imports from the West of raw materials, spare parts, components and so on; certainly they would stop functioning, and this would certainly fuel an upheaval among the Poles. They would be blaming the military junta for all of that. However, the Poles should be explained on that. That is why the free countries are doing this, why they are denying any help to the military junta, which, Senator, we must not forget that that military junta declared war on the nation. The junta is fighting the nation. The nation has the right to strike back and if that military junta is detaining and arresting people, beating them, and at the same time getting help from the West. I must say it looks to me strange and to the population in Poland it would be even more strange.

Senator **Proxmire**. So by our taking action to precipitate in effect a default, it would strengthen our position in the West and deteriorate the position of the military junta and the Soviet Union?

Dr. **Rurarz**. Exactly. Exactly, and when it comes to the West, well, I don't know. I was reading a lot of reports in the 1970's, Western reports, especially in some Western European economic press and I was wondering how childish their approach was that they were that much believing in the Polish economy. Sometimes I was even trying to tell them, but it was hopeless. They couldn't believe it. Besides, everybody believed that in case of trouble the Soviet Union would be bailing out Poland, and I don't know on what grounds they were basing those views. Right now by extending the new credits maybe some would be repaid, but this is the music of the future. I really don't see any basis in that kind of remedy and I fear this would be detrimental to the West, to the interest of the Western countries.

In other words, they have the prospect of continuing to extend the credits to the East and to Poland without any chance of seeing that money back. Even the servicing or paying the interest rate is a big question mark, not only the principal.

OTHER COUNTRIES ABOUT TO DEFAULT

Senator **Proxmire**. I have one final question. You also said a number of other Eastern European countries are about to default. Which countries are those?

Dr. **Rurarz**. Well, I think Rumania. I think sometime in the near future the same could be true of Hungary and Bulgaria. The debt on a per capita basis in Bulgaria is very high. And I would even not rule out sometime in the future big troubles for the U.S.S.R. itself and for Eastern Germany. Eastern Germany's debt, taking it on a per capita basis, is almost equal to that of Poland. Although I know they have special relations with West Germany and the Soviet Union treats East Germany like a sacred cow. But what if the Soviet exports start dropping in the near future? But what if the gas pipeline, on which the U.S.S.R. is counting so much is not realized? Then the U.S.S.R. would have no money to settle its own debt. That's my understanding, especially in the bankrupt economies as they are in Eastern Europe.

Senator **Proxmire**. In your judgment, as an expert in this area, do you think that a grain embargo in the Soviet Union would have a serious effect on the economy?

Dr. **Rurarz**. Yes, I think so. The Soviets are lacking, I think, this year only something like 43 million tons of grain, especially feed grains. And when it comes to the supply of food products, well I must say when I was in Moscow last June I saw it. There was no rationing but, nevertheless, when people were buying food they would be told not to buy too much. My colleagues from the Polish Embassy were telling me that the food situation was very critical especially in the provinces. At the same time, I understand that if they would not get those feed grains from the United States, they would not get them from Canada or Argentina or Australia, because those countries do not have that much feed grains. It is the United States which does. Besides, if you export grains you subsidize those exports. I think the Soviets are seeking the credits in Western Europe to buy that grain on credit terms. At the same time you're increasing your defense spending. I would reduce those defense spendings by $6 billion and I would pay out that money to the farmers to compensate them for not exporting the grain to the U.S.S.R. I think the gains would be even bigger than increasing spending on armaments and at the same time exporting grain. But this is of course the United States business, not mine.

Senator **Proxmire**. Thank you.

The **Chairman**. Ambassador, do you believe there can be any revival of the Polish economy without the active participation of the Solidarity union?

Dr. **Rurarz**. No. The only thing which could really stabilize the Polish economy is the consent by the people to tighten their belts. There is a necessity of belt tightening in Poland. Right now there is only belt-tightening but without any economic policies offering the improvement of the situation. And what if the Poles continue the passive resistance to the military junta? Or if they start active resistance? The belt-tightening only may be very much inviting them just to do that. Then there is no possibility that the Polish economy would improve. In some industries where there is militarization of them combined with people working longer, well, one could maybe temporarily raise that production. But when it comes to some sophisticated industries, laboratories and so on, you can't force people to be more efficient in their work. It could be just the other way round. And, of course, the Poles have a long tradition of resisting and I don't think the Polish economy can really be revived without restoration of basic human rights in Poland.

SOVIET NATURAL GAS PIPELINE

The **Chairman**. Mr. Ambassador, you touched very briefly on the Soviet natural gas pipeline. In the last 3 or 4 years I have been trying to do everything that I could to convince the Carter administration and now the Reagan administration and our Western European allies that that is an extremely foolish thing to do, to finance that pipeline, to allow the Soviets to have those credits, to allow them to defer what should be the Soviets' own social expenditures to military expenditures. Not only the dependency of the Western European allies on the natural gas would increase dramatically, but the hard currency that would flow into the Soviet Union would increase.

Would you agree that that is very foolish on the part of the Western alliance and the United States to participate in helping the Soviet Union in such a massive project?

Dr. **Rurarz**. I certainly agree with you, Mr. Chairman. I don't say I don't understand the logic behind it. I know that Western Europe has some difficulties in energy supplies, especially when it comes to natural gas. I believe that with some effort this could be somehow settled. So that not necessarily Western Europe, or rather some of the Western European countries should be relying on imports of natural gas from the U.S.S.R. Besides, all this gas deal would be financed by Western Europe, including delivery of very modern technologies. Moreover, this makes Western Europe dependent on the U.S.S.R. because it can stop deliveries of natural gas as it, by the way, stopped the delivery of titanium a year ago. They stopped it without even explaining why. And what would the Western Europeans do? Would they invade the U.S.S.R.? Probably they would be asking the United States for help in obtaining that gas. This deal would also provide the Soviets with hard currencies. At the same time they would not be compelled to try to change anything in the functioning of their economy. That natural gas would be the Mother-Earth providing them with hard currencies. So they would not be inclined to start any improvements in their economy. They would be just exporting what nature has given to them.

Besides, Senator, I must say I would not exclude the troubles in Eastern Europe. That gas pipeline goes through Czechoslovakia. Who knows what can happen in Czechoslovakia? And what if there would be some civil strife and so on? Will Western Europeans be seeing that gas coming through? I would not even be excluding if maybe the situation deteriorates to the extent that there would be some hostilities in Eastern Europe.

The **CHAIRMAN**. Well, I wish our Western allies could be more realistic and less naive and listen to some of you who have had to exist under Soviet domination.

Mr. Ambassador, I have many more questions, but we have several other witnesses today. I would like to submit some additional questions to you for your response in writing, as I'm sure some other members of the committee will want to. I know Senator Heinz would like to ask you some further questions. I can't tell you how much, on behalf of the committee, we appreciate your willingness to come and testify and do everything you can to fight for the freedom of your people in Poland. Thank you very much.

Dr. **RURARZ**. Thank you very much.

[Additional material for the record follows:]

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
March 12, 1982.

Hon. ZDZISLAW RURARZ,
P.O. Box 325,
Bladensburg, Md.

DEAR AMBASSADOR RURARZ: Thank you for your excellent testimony before the Committee on February 23. It was most helpful in clarifying the issue of default and a number of other questions concerning Poland's political and financial future.

As you remember, Senator Garn noted that there were a number of questions which he and his colleagues were not able to ask due to the time available and circumstances of the hearing. I, therefore, have attached them to this letter and would greatly appreciate your answering them for the record. You did mention in your testimony that you would be glad to submit to the Committee for the record, a copy of a document (along with English translation) regarding future credit levels proposed by the Polish Government to the Paris Group. The Committee would be very interested in that material if you would submit it to us.

Again on behalf of Senator Garn I want to thank you for your cooperation with the Committee in this hearing. Please send the answers directly to Ed Dicks, Editor, Committee on Banking, Housing, and Urban Affairs, 5300 Dirksen Senate Office Building, Washington, D.C. 20510.

With kind regards,
Sincerely,

PAUL FREEDENBERG, *Economist.*

RURARZ QUESTIONS FROM SENATOR GARN

1. If Poland is forced into default, would the Soviets be forced to assume at least part of the economic burden?

2. In your opinion, what approach is most likely to get the attention of the Soviets, a soft or a hard line approach? Would the Soviets or the current regime in Poland be more likely to make concessions on issues like arms control or liberalization within Poland in response to an offer on our part to work with them quietly, or in response to a unilateral declaration of default?

3. To what extent is the Soviet Union responsible for Poland's current inability to meet its loan obligations?

4. Some have suggested that the Soviet Union has used the Eastern European countries to obtain technology and goods from the West, urging the Warsaw Pact countries to obtain Western production facilities and then purchasing the products from the Eastern bloc countries at low cost, rather than allowing the Eastern Europeans to use the production to generate hard currency. How much of the Western credits to Poland have gone to financing exports to the Soviet Union?

5. In an interview to the New York Times you are quoted as saying, "Poland cannot be left to the Polish, because many people in key positions are following Soviet orders." Do you suggest that the Soviet Union will sabotage all economic reform, even if it is necessary to stave off default? If you don't have Poles governing Poland, then who should? How do you suggest that a negative Soviet influence be countered? Are the IMF and the World Bank viable alternatives?

6. Are you aware of any plans by the Warsaw Pact, and the Soviet Union in particular, to manipulate its economic relations with the West for political purposes?

7. Would you outline the forms of economic leverage that Moscow has at its disposal over the CMEA countries?

ANSWERS

1. Partly probably yes, but not in meaningful amount. Especially when it comes to Poland's needs of hard currencies, grains, technology and spare parts for capital goods imported from the West in the past. The USSR may, however, supply some of the raw materials, like cotton, ores and metals, pulp and phosphates in excess of amounts normally delivered to Poland. It is doubtful the same could be true of oil and natural gas.

2. The soft approach has been already tested. It has not brought any positive results. The Soviets and its Soviet-imposed regime in Poland do not make any concessions if not compelled to do. Any "quiet" diplomacy with the Soviets is counterproductive because of two reasons. Firstly, because they cannot be made accountable publicly and, secondly, the people in the Soviet empire may believe that the U.S. is virtually selling them out again.

3. The inefficient socio-economic system in Poland is of a Soviet making. Due to the fact that the Soviet "fifth column" in Poland is far stronger and Poland is strategically more important to the USSR, the latter has been unwilling to have the Polish economy departing far from the Soviet model. That model has been totally inept for an accelerated economic growth, largely financed by Western Credits. It has been obvious that such a model could never be in a position to service the debt; it has been said in Poland in governmental circles that it was for the creditors and not debtors to worry about the debt.

4. The question cannot be answered precisely. No such studies have been ever made in Poland. But the fact is that the so-called "coordination of plans" between the USSR and Eastern European countries usually assign certain "production tasks" to particular countries; usually it is the USSR assigning such tasks. Once it is so decided the countries concerned are encouraged to seed the credits and technology in the West. Newly generated production goes then for rubles or in barter for other products.

5. The NYT misquoted me a bit. I was rather saying that by having system in Poland as it is the Poles are not really running their country. Those in key positions follow the Soviet orders and preferences. Only by changing the system that subservience to the USSR may come to the end. Otherwise the USSR will sabotage all the reforms. It has plenty of evidence to this end.

As to countering the negative Soviet influence in Poland, short of its total removal, could be multifaceted. Briefly, the Soviets must know that such an influence could be costly to them in all possible spheres. Is is up to the West to decide what this cost could be.

As to the IMF and the World Bank I think that in the present circumstances Poland should be blocked to enter them.

6. The general approach of the Warsaw Pact is to take any possible advantage it can take to expand its war potential with the help of the West. The more the West is involved here the more the hostage of this involvement becomes. Besides, it is believed that any expanded economic relations create always various lobbies in the West which live on those relations. Such lobbies may be politically an asset to the Warsaw Pact. To my best knowledge such plans exist, although highly classified.

7. The most important are the oil, natural gas and iron ore supplies. The CMEA countries are highly dependent here on Soviet supplies. Any disruption of them could be a havoc here. Not only they lack the hard currencies to replace those supplies from elsewhere, but they also lack alternative transportation and processing facilities to this end; like oil refineries oriented to other grades than Soviet-supplied oil etc.

RURARZ QUESTIONS FROM SENATOR HEINZ

1. Would a formal declaration of default, or a Western refusal to reschedule any further loans, push the Poles deeper into the arms of the Soviets, or help to wean them away?

2. How difficult will it be for Poland to work its way out of its current mess?

3. You have mentioned that Poland will need massive amounts of Western capital—and not at market rates—to finance economic reform. What are your predictions for the Polish economy if that kind of credit is not forthcoming?

4. Would you assess the structural and administrative ability of the Polish Government to manage its debt, its external accounts?

5. What should the U.S. attitude be toward Polish membership in the IMF and the World Bank? Would such membership help to bring about meaningful political reform? Is Poland too far gone economically to be a meaningful participant?

6. What kind of conditionality might the West place on Eastern European membership in the multilateral financial institutions? What value is there to the argument that Polish membership in the IMF would give the West an indirect influence over Polish socio-economic affairs in a manner palatable to the Soviet Union?

ANSWERS

1. The threat is more theorethical than practical here. The Soviets are unable to draw Poland deeper into their economic grip. And not without tremendous economic cost. Poland's default could not only disrupt her economy, but the other Eastern economies, the Soviet including, as well.

2. I do not think Poland can work its way out of the present mess by continuing the "state of war", building "socialism" and remaining "closest friend and ally" of the USSR.

3. Without rescheduling and new credits from the West the Poland's GNP may fall again this year by one-fifth; after 13 percent last year, 4 percent in 1980 and 2.4 percent in 1979.

4. I do not see such a possibility. Rescheduling and new credits in 1982 should amount to some 17 billion dollars. Poland's hard currency earnings this year may not exceed 5 billion dollars. I cannot see how this could be managed.

5. In the present circumstances neither the IMF or World Bank could bring about any change in Poland. Certainly she could hardly be a meaningful participant to those bodies.

6. My answer to the question above partly covers this question also. Besides, I think that politically Poland should be specifically banned from entering the IMF and the World Bank. The USSR has been always opposing such joining by Poland. If it yielded now it is only because it counts on alleviating Polish debts by the Fund.

The CHAIRMAN. Next I'd like to invite to the witness table Lawrence Eagleburger and Beryl Sprinkel. Mr. Eagleburger, would you like to proceed.

STATEMENT OF LAWRENCE S. EAGLEBURGER, UNDER SECRETARY FOR POLITICAL AFFAIRS, DEPARTMENT OF STATE

Mr. EAGLEBURGER. Mr. Chairman, I appreciate the opportunity to appear before this committee to discuss Polish debt in the framework of our overall policies toward Poland, Eastern Europe, and the Soviet Union. I believe our discussion today will help clear away the misinformation and misunderstanding that now seems to surround the administration's policy on this complex and important issue.

Let me begin with a brief description of our general East/West policy and our policies and actions since the imposition of martial law in Poland. The Reagan administration came to office believing—and it continues to believe—that East/West relations must be a two-way street. The Soviet Union cannot expect to continue business as usual in the economic realm, if it persists in attempting to solve political problems in other sovereign countries by force and in flagrantly encouraging and abetting violations of human rights in complete disregard of its obligations as a signatory of the Helsinki Final Act.

The Western alliance is in full agreement that the Soviet Union bears a heavy responsibility for, and is deeply involved in the repressive policies of the Polish regime. The current repression in Poland represents yet another illustration of the failure of the Soviet-imposed Communist system in Eastern Europe. The Soviets are trying to mask this failure by dividing the Western alliance on the question of sanctions against Warsaw and Moscow. We and our allies are determined not only to avoid such a division, but in fact to strengthen the alliance through a firm, common effort to impose costs on the Polish and Soviet Governments commensurate with the violation of acceptable political behavior now taking place in Poland. We are firmly agreed that the West must demonstrate to Warsaw and Moscow that actions which violate accepted standards of conduct will not go unnoticed and unpunished, but equally that we will not allow this failure in the Communist system to be transformed into a failure of the Western alliance.

NATO COUNTRIES SET OBJECTIVES

The NATO countries have set out three objectives that must be met before measures already taken—and additional measures that might be taken—would be reversed: One, lifting martial law in Poland; two releasing the detainees; and three, restoring the dialog between the Government, Solidarity, and the Church. We will continue in our efforts to exert sustained pressure on the Polish and Soviet Governments until those conditions are met.

To this end, we and our allies have taken common measures against the Polish Government as well as complementary unilateral measures against both the Polish and Soviet Governments. We have pledged also not to undercut each others' measures. I will not take your time here listing all the various measures that have already been taken. As you know, we and the other NATO countries have additional measures under active consideration, if the situation does not improve.

Poland owes about $26 billion to the West, over $20 billion of that to the industrialized countries. Prior to the December 13 imposition of martial law, Poland could not pay this debt on schedule. The 16 major official creditors agreed last April to reschedule those Polish debts due in 1981. The Western banks appear to be about to conclude a rescheduling of Poland's 1981 private debt obligations. Insistence that Poland repay this debt to the West has provided, and continues to provide, a pressure point for Western governments in pursuing political and economic aims in Poland.

Among the common measures taken against Poland, the NATO ministers decided that they would suspend consideration of negotiations on rescheduling Polish debt in 1982 under current circumstances. This allows Western creditors to press the Poles for timely repayment of their debt obligations. We all agree that this provides the West with one powerful tool for keeping pressure on the Polish Government—and indirectly on the Soviet Government.

This policy has been questioned in the press and by some members of Congress. Many seem to believe that we could exert more pressure by declaring Polish loans in default now. Our analysis leads to the opposite conclusion.

CONTINUE PRESSURE FOR REPAYMENT OF DEBT

The Polish Government is paying on its debt obligations, albeit slowly and partially. There are no new credits going to Poland. Thus, there is a small flow of financial resources from Poland to the West, while, at the same time, the Soviet Union is providing significant assistance to Poland. By continuing to press the Poles hard for repayment, we keep the pressure on them to divert a part of their very scarce foreign exchange to the repayment of debt. This forces them to reduce needed imports from the West, and thus magnifies the economic pressures on them, and it tends to force a continuing high level of assistance from the Soviet Union.

In contrast, a declaration of default, at this time, would reduce that pressure. While, default would not legally absolve the Polish Government of its debt obligations, it might be portrayed by the Poles as a political act—since the Korean war, to our knowledge, no sovereign government has been declared formally in default—and thus could give the Poles a political excuse to stop repaying those creditors that called default. They would have nothing to lose, as they are getting no new credits now anyway.

Moreover, there is no assurance that other creditors would follow our lead on this. The private banks have had, and continue to have, opportunity to declare default. They have not done so. Our European allies are in firm accord with us that pressing the Poles for repayment, rather than declaring a default, is the best way to sustain financial pressure on the Polish Government at this time.

A declaration of default remains an option open to us at any time we believe circumstances warrant its use. The actions we have taken so far preserve the option; they do not preclude it. We will continue to keep this option open, and to maintain a dialog with our allies on its implications as well as its advisability.

Mr. Chairman, in conclusion let me briefly summarize the administration's position on the Polish debt issue:

We want to keep sustained pressure on the Polish and Soviet Governments to achieve our stated political objectives.

We and our allies are in firm agreement that one way of doing this, at present, is to continue to insist that the Polish Government meet its debt service obligations.

Default would not increase this pressure, but, in fact, reduce it by giving the Polish Government an excuse not to repay those creditors calling default.

A unilateral declaration of default at this time would be divisive to the Western alliance.

Default remains a live option, which we can use at any time, if circumstances warrant.

The **Chairman**. Thank you.

Mr. Sprinkel.

STATEMENT OF BERYL SPRINKEL, UNDER SECRETARY FOR MONETARY AFFAIRS, DEPARTMENT OF THE TREASURY

Mr. Sprinkel. Mr. Chairman, I welcome this opportunity to discuss the Polish economic and financial situation with you and other members of the committee. In my prepared statement, I will review how the situation has deteriorated to the position in which Poland finds itself today, the debt rescheduling exercise with official creditors for dealing with Poland's 1981 maturities, the parallel exercise with the commercial banks which appears to be in its concluding phases, and most importantly, the economic and financial pressures we have brought to bear on Poland and the Soviet Union in the light of the repressive actions of December 13, 1981. In particular, I will set forth the administration's view as to why we have not declared Poland in default on its official debts, because we see this as a means to bring greater pressure to bear on the Polish regime. There has been considerable misunderstanding and confusion on this subject, and I think it would be helpful to understand the position we have taken and why.

POLAND'S ECONOMIC STRATEGIES

In the early 1970's, Poland embarked upon an ambitious economic development program to modernize its economy and to increase substantially its standard of living. The strategy envisaged a simultaneous expansion in investment and consumption. Massive increases in investment were needed to reorient the economy away from inefficient import substitution and toward the development of an export oriented industrial base. This would enable Poland to sell its products in Western markets. Concurrently, it was felt that increases in consumption, particularly of food, would be required to provide Polish workers with an incentive to stimulate the growth of output.

In this strategy, it was recognized that substantial foreign borrowing, primarily from the West, would be necessary to finance massive capital imports from the West. The Poles thought that the trade deficit which this would elicit would ultimately shift into a trade surplus as a result of Polish sales in Western markets; the surplus was envisioned to become large enough to enable Poland to eventually reduce its external debt.

THE POLISH FAILURE AND BUILDUP OF DEBT

This strategy failed, and failed badly. The main problem arose because the Polish authorities made a number of policy errors. For example, when the Western recession began in 1974, Poland, like a number of developing and industrial countries, maintained its ambitious development plan rather than cutting back on imports which were used to build its industrial capacity. As a result, its trade deficit with the West widened, and for 1975, it exceeded $2 billion compared to $1.5 billion in 1973. Incorrect income and pricing policies also played their role as Poland tried to insulate its economy from the inflationary pressures of the mid-1970's through use of subsidies and price controls. These measures increased the degree of distortion already existing in this centrally planned economy and exacerbated the financial problems of Polish enterprises. The emphasis on expansion of heavy industry resulted in a neglect of the agriculture sector. The combination of 6 consecutive years of bad weather and the lack of appropriate agricultural policies gave rise to rapidly increasing rates of food imports—more than doubling between 1972 and 1975, and increasing by one-third again between 1975 and 1979. These imports necessarily had to be covered by Polish exports. But when Poland found it was unable to generate the level of export sales it envisaged, these imports had to be covered by additional borrowing.

As a result of these and other developments the Polish external debt situation deteriorated significantly. For example, in 1972, Poland's gross hard currency debt totaled only $1.6 billion. Its debt service, consisting of $200 million of principal and $74 million of interest, amounted to only 15 percent of its foreign exchange earnings from the West. As Poland's hard currency imports continued to exceed its hard currency exports, total debt and debt service continued to rise. By 1974, Poland's external debt was $4.6 billion and its debt service was 23 percent of export earnings; by 1976, total debt more than doubled to $11.5 billion and debt service was 42 percent; by 1979, total debt virtually doubled again to $21.1 billion and debt service was 92 percent—see the table attached to my statement. Poland was now truly caught in a vicious circle wherein a rising standard of living that its people had come to expect and demand depended on ever-growing borrowing from the West.

By midyear 1981, Poland's hard currency debt stood at approximately $26 billion. It owed roughly $20 billion of this amount to 16 Western countries, $11 billion to official creditors or guaranteed by them, including $1.9 billion to the U.S. Government; and $9 billion of unguaranteed debt to private banks including $1.3 billion to U.S. banks. At the beginning of 1981 it was estimated that Poland would require some $11 billion to cover its projected trade deficit and service its debt. Poland was clearly not in a position to raise these amounts and on March 26, 1981, the Polish authorities notified their creditors that they would no longer be able to guarantee payment of their external debt.

PUBLIC AND PRIVATE DEBT RESCHEDULING

The governments and private banks responded to the Polish notification by agreeing to enter into debt rescheduling negotiations. Separate debt rescheduling exercises were organized by the official and private creditors. Fifteen official creditor nations—later increased to 16 with the addition of Spain—concluded negotiations with the Government of Poland and a multilateral debt rescheduling agreement was signed in Paris on April 27, 1981. This agreement serves as an umbrella agreement for subsequent government to government agreements to reschedule 90 percent of Poland's debt service obligations to these creditors, including both the principal and interest falling due during the last three quarters of 1981. These obligations, totaling $2.4 billion, are to be repaid during a 4-year period beginning in 1985. Interest on the rescheduled debt, both interest and principal, is to be charged during the 1981-85 grace period and on the outstanding debt during the repayment period. The U.S./Poland government to government agreement was signed on August 27, 1981.

Western banks, moving on a parallel track, established a consortium to negotiate a debt rescheduling agreement with the Polish Government. By September, the consortium reached an ad referendum agreement with the Poles for rescheduling 95 percent of the principal—$2.3 billion—falling due during April-December 1981, over 8 years, including a 4-year grace period.

The consortium of Western banks set a precondition for signing the document, namely that Poland pay all of the 1981 interest—an estimated $700 million—which fell due in the last 9 months of 1981. The Government of Poland could not completely fulfill this condition at year's end, and as a result, the Western banks did not sign the rescheduling agreement. At the present time, we understand the Poles have almost brought their interest payments to the banks current through December 1981. Final payment of 1981 interest—and signature of the rescheduling agreement with the banks for 1981—is expected in March.

INTERNAL DEFICITS: THEIR CAUSES AND IMPACT

The problems created by the massive buildup of Poland's external debt were exacerbatd by the growth of large scale budget deficits which rose from 26 billion zlotys in 1980 to over 200 billion zlotys in 1981—34 zlotys=$1—an amount equal to about 6 percent of their GNP. These deficits came about primarily from three sources: First, increased government expenditures for social benefits; second, higher wages in administration, education, and other units financed by state funds; and third, losses of socialized enterprises because of rapidly rising wage increases, declining output, and stagnant prices.

The Polish response to these developments was to finance the overall budget deficit by monetizing the debt. Rather than take corrective measures to eliminate the budget deficits, the Polish authorities printed money. The Polish Government has estimated that nearly 22 percent of their expenditures in 1981 were financed by newly issued money. With official prices suppressed, a thriving black market developed. As a result, the Polish currency became worthless, both as a medium of exchange and a store of value. It was no surprise to economic observers that in these circumstances Polish workers would not produce when they were to be paid in a currency which was virtually wortheless; and it was no surprise that the Polish farmers would not bring their products to market in the state distribution systems when they too would be paid in a worthless currency.

BRINGING PRESSURE TO BEAR ON POLAND

Subsequent to the imposition of martial law in Poland on December 13, 1981, the United States and other official creditors took financial measures to bring financial pressure to bear on Poland. First, government credits and export guarantees to Poland have been limited to those of a humanitarian nature, for example, food and medical supplies. In this regard the U.S. Government has terminated all discussions regarding CCC loan guarantees for agricultural exports, while permitting food assistance which was in the pipeline and was being distrubuted by Catholic relief services and CARE was allowed to continue to go forward. Second, the official creditors suspended indefinitely any talks with the Poles on rescheduling their 1982 debt maturities and are insisting that the Poles service all their 1982 debt obligations as they fall due. They are also insisting that the 1981 obligations which were not rescheduled and are in arrears, be paid.

By these actions, we are creating a situation whereby funds are flowing from Poland to the West rather than from the West to Poland as was the case just 1 year ago. By adhering to a policy of pressuring the Poles for repayment while not providing any new credits, we can perpetuate a situation that hurts the Polish regime. The net outflow of funds means that the Poles are giving up more than they are getting, and as I pointed out above, they are getting no new funds.

In these circumstances, would declaring a default now bring more pressure on the Poles than that which now exists? I don't think so. In fact, declaring a default now could make things easier for the Polish regime. This sounds like an anomaly but in fact it is not. If the U.S. Government were to declare a default now, as some have argued we should, the Polish Government could use that as an excuse to keep from paying even the small amounts which it is presently paying. Thus, they would be free to use their scarce foreign exchange either to pay other creditors—who might not declare default—or make new purchases. We do not wish to bring about this type of situation as it would ease the pressure with which the Poles are now confronted.

Thus, the administration has determined that we can maximize pressure on Poland by insisting that they pay their indebtedness. We firmly believe that this policy is the most effective for advancing our political and financial interests.

I will be happy to answer any questions which you or other members of the committee may have.

[Copy of table attached to statement follows:]

POLAND

[In billions of U.S. dollars]

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981 (estimate)
Non-Communist:										
(a) Exports	1.8	2.5	3.9	4.1	4.4	4.9	5.5	6.3	7.4	5.6
(b) Imports	2.0	4.0	6.0	7.4	7.5	7.1	7.5	8.8	8.8	6.5

POLAND—Continued

[In billions of U.S. dollars]

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981 (estimate)
(c) Trade balance	−0.2	−1.5	−2.1	−3.3	−3.1	−2.2	−2.0	−2.5	−1.4	−0.9
Gross debt	1.6	2.8	4.6	8.0	11.5	14.0	17.8	21.1	25.0	26.0
Principal repayment	0.2	0.3	0.5	0.7	1.2	2.0	2.9	3.6	5.6	6.4
Interest	0.1	0.2	0.4	0.5	0.7	0.9	1.5	2.2	2.4	3.3
Debt service (as percent of exports)	15	19	23	30	42	59	79	92	108	173

The CHAIRMAN. Thank you very much.

Mr. Sprinkel, my first question to both of you would be simply why is our State Department and Treasury Department so much smarter than a former Polish Ambassador who's been at the heart of their economic policy for several years? I'm sure you heard him testify that we ought to call default. Is our intelligence so good that we know more about their internal affairs than he does?

Mr. EAGLEBURGER. Mr. Chairman, I have great respect for Ambassador Rurarz. I think this is a case, as has been evidenced for some weeks, of a very substantial disagreement on the question of default. It's been debated in this city and in the press for some weeks and I think we just come up with a different answer. I think the objective that the Ambassador and we are talking about is the same, which is putting as much pressure as possible on the Polish Government as well as on the Soviet Government to try to bring about some modification in the situation in Poland.

PARTIAL PAYMENTS BEING MADE

Where we differ is on the question on what is the toughest way to proceed. Our view is that in fact by not pushing for default there is more pressure on Poland because they do continue to pay off to some small degree, as Mr. Sprinkel has said, some of the interest, and that in fact were we to declare default we would be lessening pressure on the Polish regime. I think there's just a difference of view on this. I wouldn't deny that the State Department and Treasury Department as far as intelligence——

The CHAIRMAN. You still haven't answered my question. I understand your position. I understand the difference of opinion. I have been following the debate for weeks as well. I'm just wondering where we are so firm on our position that it's almost like me being in some other country and having been chairman of the Banking Committee and their experts on banking say, "We're sorry, we don't agree with you on what's going on in the banking system in the United States. We know better than you do from your position." Why do you think your position is better than his, as someone who has served internally in their government?

Mr. SPRINKEL. I also have great respect for the former Ambassador. I suspect, though, that we know a bit more about U.S. interests than he does. The real question is which way is the money flowing? Is it flowing into Poland or out of Poland as a result of our policy? Right now, it's flowing out of Poland. We still retain the option of declaring a formal default. But in the meantime, money is coming our way and not theirs. They probably would not have paid us if we had formally declared them in default. We can't be certain, but that's a reasonable assumption.

The CHAIRMAN. I'm sure we do know more about our economy than he does, but again, my question is, I would expect he might know more about theirs than we do, and he seems to think that default would hurt them more. But I can see we're not going to resolve that question.

You mentioned that the administration is not going to reschedule the 1982 debt, Mr. Sprinkel. Obviously, the Poles are not going to be able to come up with those 1982 obligations. So what are you going to do when the debts comes due?

Mr. SPRINKEL. Well, at the present time we are continuing to insist that they pay. They are making small payments now, and we expect they will continue. At this point we are not considering the possibility of rescheduling. As events develop, we will have to decide what to do, but we don't have to do it today.

The CHAIRMAN. Mr. Eagleburger, do you have any arrangement or understanding with the Europeans not to call for default without first obtaining their consent?

Mr. EAGLEBURGER. Mr. Chairman, not in the specific way you put it, without obtaining their consent; that is not correct; but we have made it clear that this is an issue on which we would consult before we agreed to it.

The CHAIRMAN. Do our European allies view the Polish debt in solely economic terms, rather than as an opportunity to exact political concessions from the Polish regime—or even the Soviets—in return for debt rescheduling and further short-term credits?

GENERAL AGREEMENT WITHIN NATO ALLIANCE

Mr. EAGLEBURGER. I think the view of the allies on the subject is mixed, with some feeling solely in economic terms and some others recognizing that there is a political component. I think basically, however, Mr. Chairman, that within the NATO alliance there has been a general agreement much along the lines of what we have already said to you this morning, that in fact not declaring default at this point is the tougher option with regard to both Poland and the Soviet Union.

The CHAIRMAN. Is there any way we can get our Western allies to change their perspective and join us in attempting to use credit and debt rescheduling for political objectives?

Mr. EAGLEBURGER. Mr. Chairman, without going too far at this point, I think I can say that the whole question of export credits in particular and Western, including Japanese handling, of the question of future export credits is an issue which is now being looked at very closely within the U.S. Government. Frankly, the objective is to see if there isn't some way, with our allies, that we can get a much firmer hold on this, recognizing that export credits is a strategic issue; it's not simply a business issue. And that, in fact, within the West there is great need to find some management mechanism which will have greater control over the issuance of export credits. Whether we will be successful in the discussions with the allies, I cannot at this point predict.

I think I would say that, on the basis of the early discussions we have had, we will find that they are at least receptive to discussing the issue. How far we go beyond that at this point, I can't say.

Mr. SPRINKEL. In addition, we should recognize that the markets are working as you would expect. There's greater fear and concern about principal and interest payments, so lenders are no longer extending extensive credits to Poland, Russia, or any other Eastern European country. The few credits being provided are directly related to short-term trade flows or are government backed. In general there's been a very sharp contraction in the extension of credit to Eastern Europe.

The CHAIRMAN. I really wonder about whether we're more fearful of financial problems than Poland seems to be intimidated by the size of their own debt. Poland owes the West $26 billion. Warsaw Pact countries owe the West $73 billion. I wonder really who has more leverage, the debtor or the creditor?

Mr. SPRINKEL. Well, I'd rather be the creditor if I had the choice, but both have problems, obviously.

Our problem is trying to find ways to get paid what we are owed. Their problem is, indeed, a very difficult one: They have to earn enough funds—which they are not now doing—to eventually retire their debt and to make themselves creditworthy so they can borrow in the future. Until massive changes occur on both the political and the economic fronts, they are going to have great difficulty in doing that.

The CHAIRMAN. Well, you see, I'm much more concerned about the political consequences than I am about the dollars. I'm trying to determine how we can put the most leverage on them because, frankly, I think the Carter administration and this administration is involved in a great deal of rhetoric about how much we want to punish the Soviet Union and their allies for their transgressions in Afghanistan, Poland, and other places around the world, and now Central America and so on; but we don't really get tough. I don't see any toughness in either administration. It's all talk. Your opening statement is the same argument I've heard before this committee for years about how we are going to get tough economically with the Soviet Union, and I've never seen anything from either administration that I have observed other than words.

When are we really going to get tough with them? We slap their hands and they must laugh at us. They get a little smart on the hands from Afghanistan and a little smart because of Poland, but we're not really tough. We don't really put the economic screws on them. But I don't ask you to defend the whole administration and the Carter administration. I just wish that in this area, as much as I support this administration in other areas, we could finally get to where we could use the economic tools that I would think would hurt the Soviet Union so dramatically, and yet we won't do it. Yet we continue to increase the defense budget and work on the pipelines and let them divert more money to their military away from their domestic, when I think we could put the pressure on them to have to spend less on military in order to beef up their own economies if we wouldn't continue to help them.

Do you believe that the West gives liberal credit terms with which we have been inadvertently selling and financing the rope with which to hang ourselves by allowing the Soviet Union to devote such a large proportion of GNP to military spending?

CREDIT FLOW TO EASTERN EUROPE HALTED

Mr. **Sprinkel**. There's no doubt that the extensive credits provided by the West over the last several years have been beneficial to Eastern Europe and the Soviet Union. Those credits are not flowing now, and haven't been for some time. I suspect they will not flow again in the future until there's a change in the political and economic environment in the area.

Mr. **Eagleburger**. Mr. Chairman, if I could add, we talked earlier about the question of export credit. I think there is, as I indicated, at least the possibility—well, more than a possibility—I think it's clear that we are going to force some consideration with our allies on the whole future of the export credit process and if I can say a word at least in defense of the Reagan administration, I must respectfully disagree. I think that the sanctions thus far taken by the President, both with regard to Poland and with regard to the Soviet Union, have definitely had bite. I don't want to bore you today with a long list of what those sanctions are, although I have a list here if you would like it for the record. I would not deny at all that particularly with regard to the Soviet Union there are other sanctions still available to us. I think it's important, Mr. Chairman, to keep in mind, however, that that Polish event is not yet over and it is I think incumbent on us to try to keep some sense of how we use the sanctions we have or have available in terms of trying to judge whether we can move the situation in Poland and the Soviet Union in either way, and also it is a fact at this point at least the Soviet Union has not moved as far as we at one time thought they might.

The **Chairman**. Have they ever, with the wrist slapping we have been giving them in the last few years?

Mr. **Eagleburger**. I'm talking about what they did in Hungary and Czechoslovakia. But my point is that it's fairly clear over the last several years the Soviet Union has done its best to avoid an intervention in Poland, a direct intervention. There is an open question I think as to where the internal events in Poland are going to go. I think Jaruzelski has a tiger by the tail and doesn't know how to let go, and I think the situation in Poland is going to get much worse, and I would suggest to you, sir, that there is at least a respectable argument that we need to maintain some possible sanctions so the Soviet Union recognizes there is some constraint to their further action.

Now there's a perfectly legitimate area for debate here on whether, if we had taken them all in the first instance, that would have hurt more than if we hold some back in the event the Soviet Union goes further and, indeed, whether holding some back restrains the Soviet Union to some degree. But I would suggest that at least it's a legitimate issue for debate amongst diplomats and Senators.

The **Chairman**. I'm not suggesting that you do it all at once. I'm saying it's a bite. I agree there's a bite. It's how big that bite is and how fast we are going to chew on that tiger tail and keep on biting. Normally we back off. We certainly backed off in Afghanistan. We did nothing significant to them about Afghanistan. It's easy to see why the Western European allies have been involved in war all their history. Over and over and over again they never learn about détente or anything else, whether it's previous to World War I or World War II, and over and over again they continue to be so naive that I suppose they will always be involved in war and I suppose they need to get a little tougher and get some backbone from this country as well.

Senator Proxmire.

Senator PROXMIRE. Let me congratulate you on these witnesses, Mr. Chairman. These are two classy fellows and I respect them both. Mr. Sprinkel has testified for many, many years as an outstanding expert on monetary policies and he's a fine economist. Mr. Eagleburger has an even higher recommendation. He comes from Wisconsin—Stevens Point, too—right in the heart of Wisconsin, and they're very proud of you back there, Mr. Eagleburger. They follow your career with really great pride.

Mr. EAGLEBURGER. Senator, I hope they still will be after we finish this hearing.

Senator PROXMIRE. Well, they are prouder all the time.

The CHAIRMAN. We don't have any economists from Utah. We don't allow them. We're trying to do away with attorneys as well.

Senator PROXMIRE. Mr. Sprinkel, at the very end of your statement you have a very helpful chart showing the gross debt, principal repayment, interest, and so forth, of Poland. You show the gross debt of Poland for 1981 at $26 billion; the principal repayment at $6.4 billion for 1981; and $2.3 billion in interest.

Can I ask you or do you have the data on how much of that principal repayment interest was actually paid in 1981?

Mr. SPRINKEL. On the official debt, they paid through the first quarter, and then 90 percent of the principal and interest falling due during the last three quarters on the official debt was rescheduled.

Senator PROXMIRE. They paid for the first quarter and then the remainder of the year was rescheduled?

Mr. SPRINKEL. Yes, sir; 90 percent of what was due the remainder of the year was rescheduled.

Senator PROXMIRE. So the remainder of 1981 was not paid?

Mr. SPRINKEL. Only 10 percent—the nonrescheduled portion—was to be paid. They are in arrears on the 10 percent, however.

Senator PROXMIRE. And you also state, on page 4 of your statement, that $1.9 billion was loaned by the U.S. Government or is obligated by the U.S. Government, and $1.3 billion by U.S. banks.

Mr. SPRINKEL. Yes, sir. The $1.9 billion includes the guaranteed private loans.

Senator PROXMIRE. How much of that, if any, was direct loans from the U.S. Government?

Mr. SPRINKEL. Direct credits and guarantees by the Commodity Credit Corporation, totaled $1.6 billion; Export-Import Bank loans were $244 million; and AID loans $6 million. I do not have a breakdown for the Commodity Credit Corporation between direct and guaranteed credits. The total is $1.6 billion; I can give you the breakdown later if you want.

BANKS PAID AND THE GOVERNMENT NOT

Senator **Proxmire**. Now the payments that were made, were they made equally to the banks through the first quarter and to the Government or were the banks paid fully and the Government not?

Mr. **Sprinkel**. It now appears that the banks have been paid all of their interest for 1981. If it's not there now, it will be very shortly. And, of course, the Government was not rescheduled earlier in the year.

Senator **Proxmire**. So the banks were paid and the Government was not. The taxpayers didn't get it, but the banks did?

Mr. **Sprinkel**. Payment of interest was set as a precondition by the banks for their rescheduling agreement.

Senator **Proxmire**. Is that also true of the obligation to Western European banks and to Western European governments?

Mr. **Sprinkel**. All Western banks offered the same terms; the governments rescheduled 90 percent of principal and interest due April–December 1981.

Senator **Proxmire**. So their banks were paid and their governments were not?

Mr. **Sprinkel**. Yes; in accordance with their respective rescheduling agreements.

Senator **Proxmire**. How do you justify that kind of discrimination where the banks are paid and the Federal Government as a trustee of the taxpayers was not paid?

Mr. **Sprinkel**. The Government rescheduling was signed on April 27, 1981, as part of an umbrella agreement. There had been no negotiations at that point between the Poles and the banks. In order to provide the assistance the Polish Government required the creditor governments agreed that 90 percent of both principal and interest would be rescheduled. After the governments had completed their agreement, the private banks reached an agreement and one of their conditions, which was not one of the government conditions, was that all interest for 1981 be paid before they would sign the rescheduling agreement. In any event, the banks initially rescheduled 95 percent of principal and then postponed the remaining 5 percent until 1982 whereas the governments rescheduled 90 percent of principal and interest.

Senator **Proxmire**. Is that rescheduling still being negotiated or has it been finalized?

Mr. **Sprinkel**. They reached a tentative agreement during the latter part of last year, but the signing depended on the banks getting their interest for 1981. It's my understanding that almost all of the 1981 interest for banks has now been paid. That and the payments on the unrescheduled government funds have constituted the net flow of funds into the West in recent months.

Senator **Proxmire**. If they reached a tentative agreement, does the tentative agreement provide what kind of payments will be made in 1982?

Mr. **Sprinkel**. It is my understanding that once the interest is paid and the 1981 agreement is signed they will begin the formal rescheduling negotiations on the 1982 debt. What happens with that debt will depend on the terms of agreements that they reach.

Senator **Proxmire**. But you can't tell me what the tentative terms are as far as repayments in 1982—50 percent or whatever?

Mr. **Sprinkel**. I cannot.

Senator **Proxmire**. I presume it would be a fraction of the interest actually owed, or is that a correct presumption?

Mr. **Sprinkel**. I don't know.

Mr. **Eagleburger**. Senator, may I just add one point—and Under Secretary Sprinkel can correct me if I'm wrong—but I think it's important to remember that the Government debt rescheduling was in April of last year at a time when the West was hopeful that we could indeed encourage the continuation of the reform process in Poland. So that this action was taken long before the December 13 events and obviously, under those circumstances, I think as indeed with the 1982 rescheduling, governments of the West would have taken a different view of the process of rescheduling.

Senator **Proxmire**. Well, now, you both argue that it's to our interest and it's a penalty as far as Poland is concerned to require them to pay and not put them in default. If this is true, why doesn't Poland default? Isn't it true that any debtor is put in a very difficult position if they ever default? The reason why a sovereign country hasn't defaulted is because then any credit in the future becomes extraordinarily difficult to secure.

New York City, when they were before us—and we have a distinguished witness coming up right after you, Mr. Rohatyn, who's an expert in that area—would have been in frightful condition if they had defaulted. I wasn't afraid of it being in that condition but others with us were. But as far as a country like Poland is concerned, once they are defaulted, it's going to be extraordinarily difficult for them and very difficult for their big sponsors, the Soviet Union. It would seem to me that the case is very powerful that if they are really threatened with the prospect if we elected to default them that the Soviet Union would have to come up with funds to repay us.

Mr. **Sprinkel**. You're correct, but in the long run anyone who defaults on his debts, pays a price in the marketplace. It would be very difficult for the Poles to restore their credit rating. We have not renounced the option of declaring the Polish Government in default. What we are trying to do is to keep the maximum pressure on them and over time we will bring more to bear. I don't think the Polish or the Russian Governments believe that it's to their advantage to rush into a default situation. We may put them there, but we haven't chosen to do so yet.

Senator **Proxmire**. Why wouldn't it be to their advantage, if your reasoning is correct? If this simply would require them to bleed a little more and to pay us more, why wouldn't they be better off simply to default if you say that would ease the pressure?

Mr. **Eagleburger**. Well, Senator, I was going to say that—and I hesitate to tread in the bankers' territory here, but let me try with two points.

First of all, it seems to me that you're correct; one of the reasons the Polish Government has not declared a default itself is because in the long run it hopes it will be able to restore its creditworthiness. That's from their point of view an objective, and consequently, they have been repaying some of the interest.

From our point of view, on the other hand, it is clear it seems to me and we have all made it clear, as long as the repression continues in Poland, there is no chance of any government credits from this country and, indeed, I think from the West, and I think, indeed, from the private banks from their own estimates of the business situation in Poland as well as because they see what the U.S. Government is doing.

So again, I think it's a question of two different objectives, but I would never state that if the Polish Government were in fact to recede from the repressive measures it has taken and try to return Poland to what it was anti-December 13, that the West would then—there's at least a possibility that the West would then want to continue with or resume credits to Poland, obviously with conditions. But, in other words, as long as the situation in Poland stays as it is, I don't think there's any chance that the West is going to give credits to Poland anyway.

On the other hand, the Poles have got to worry about their creditworthiness over the next decade or whatever.

One more point, Senator. Whatever else the merits or demerits of declaring default or not declaring default may be, I think it is wrong to assume that under any circumstances the Soviet Union will pick up the Polish debt. We have seen no evidence of this. We don't think they will do it and we don't think there's really very much argument to be made that we should force a default because that would force the Soviet Union to pick up the debt. I just don't believe that will happen.

VARYING DEGREES OF CREDITWORTHINESS

Mr. **Sprinkel**. One point I might add, Senator Proxmire, is that there are varying degrees of creditworthiness. Perhaps the worst is default. Not being able to make payments on time is not good for your credit rating either. Clearly, Poland, Russia, and the other countries of Eastern Europe need credits from the West. Poland is striving to make as many payments as they possibly can, and we are very happy to continue to extract a net flow of funds from Poland to the West.

Senator **Proxmire**. Well, the trouble is that it seems to me our purpose should be to bring down the Jaruzelski government. Our purpose ought to be to embarrass and make it much more difficult for the Soviet Government not to help them, not to make it possible that somehow maybe they will be able to come through and cooperate in their effort to keep themselves creditworthy.

Mr. **Sprinkel**. What they need is a positive flow, and they're experiencing a negative one: that is, funds flowing from them to us; and if we declare default that might not continue.

Mr. **Eagleburger**. Senator, I was just going to say I think, again, the objective that you have described, both with regard to the Jaruzelski regime and the Soviet Union is the same. This discussion deals in a sense only with whether a declaration of default puts more pressure on or less at the moment, and that's where we're having our disagreement at this point, not with the objectives you have stated.

Senator PROXMIRE. Mr. Sprinkel, I just have one other question. My time is up but the chairman has very courteously permitted me to continue with one more question.

You say that the strategy of borrowing from the West to finance export capability failed badly. You say the main problem arose because of policy errors by the Polish authorities. I wonder if that doesn't miss the essential point.

The Polish Ambassador testified that the Soviet Union would not ever permit structural reforms. Isn't it obvious that if the U.S.S.R. is willing to abide by its obligations by the Helsinki accord that Western finance is throwing its money away?

Mr. SPRINKEL. It may be that the countries in Eastern Europe will never prosper because they will not utilize market forces in allocating their resources. But this is just one of the factors behind their lack of success and they are not unique in this regard. I could give you other reasons as to why countries in Eastern Europe have not prospered and cite other countries that are in the same boat. We have just completed work on some of the developing countries, to see why some of them have done well and others poorly. Their performance is usually dependent on the kinds of policies followed by their governments. As is the case with Poland, they do not permit market forces to have an important role in their economies; they insist instead on using price controls and subsidies, and eliminate incentives.

POLICY OF DIFFERENTIATION

Mr. EAGLEBURGER. Senator, if I may, to show how soft I really am, I do believe there is merit to what we call the policy of differentiation, and I'd like to simply say that I think while dealing with the Soviet Union is one issue, that there is merit to dealing with the Eastern European satellites of the Soviet Union with some differentiation in the policy.

For example, I think that what we have seen develop in Hungary over the course of the last 5 years at least offers some hope that in fact market forces will be permitted to play some role. I think it does indicate, as well, that the life of the average Hungarian has been permitted to develop a bit more than in a lot of the rest of Eastern Europe and that in fact it is a little more liberal regime. I think that is worth some consideration on the part of the United States, both in terms of the impact within the area itself and in terms of the specific situation of Hungary.

I spent 3½ years as our Ambassador to Yugoslavia, which, while not in the Warsaw Pact, is a Communist state—but the whole history of that country since the break with the Soviet Union has been an attempt, within a restrictive system admittedly—has been an attempt to try to liberalize internally and, indeed, to introduce things like incentives, I think with some success. I think we need to be very careful in looking at Eastern Europe and the Soviet Union to recognize there are differences and that the encouragement of those differences, at least on occasion, is in the best interest of the United States.

Senator **Proxmire**. I agree with that mostly, but not entirely.

The **Chairman**. To follow on with that, do you feel that default of Poland would adversely affect Hungary and Yugoslavia?

Mr. **Eagleburger**. If I may answer it from a political point of view, I don't know what the answer would be. I think there is at least, Mr. Chairman, a danger that default in the Polish case would create the sort of—well, it already has to some degree—created a psychology in which loans are not flowing eastward. I think there is at least a danger that it could have an impact on Hungary, on Romania, and indeed if Hungary and Romania are affected, on Yugoslavia. I think the Yugoslav case is somewhat a case apart, but I wouldn't exclude the possibility if things really began to come apart.

The **Chairman**. Thank you very much, gentlemen. I have 4 or 5 pages of additional questions that I will submit to you for your response in writing. I do admire you for your defense of your position. I have yet to decide in my own mind whether we should or should not call for default. Obviously, there are good reasons on both sides. You have presented your case well and I thank you for coming today.

Mr. **Eagleburger**. Thank you, Mr. Chairman.

Mr. **Sprinkel**. Thank you for inviting us.

The **Chairman**. Mr. Rohatyn and Mr. Petty, would you come forward, please? If you wouldn't mind waiting for just a moment, I understand Senator Kasten is out in the hall. If he is, please sit down and we would give him an opportunity to testify briefly if he is outside the door.

Mr. Rohatyn, why don't we go ahead and start while we're waiting for Senator Kasten. We're very happy to have you before the committee and on a different issue than you have been before us before. But we are happy to have you with us.

STATEMENT OF FELIX G. ROHATYN, SENIOR PARTNER, LAZARD FRERES & CO., NEW YORK, N.Y.

Mr. **Rohatyn**. Mr. Chairman, members of the Senate Banking Committee: I welcome the opportunity of testifying once again in front of your committee, this time on the subject of the Polish debt. I have had the privilege of giving testimony here a number of times over the past 6 years as chairman of New York's Municipal Assistance Corp. It is a new experience for me to be testifying, for once, about someone else's possible bankruptcy.

POLAND SHOULD BE DECLARED BANKRUPT

I hold, as you know, firmly to the view that Poland should be declared bankrupt, that the rescheduling of Poland's debts, as well as those of other Eastern European countries such as Romania be suspended; that new credits to Eastern Europe should not be made available by the Western banking system at this time; that the financial and economic burden of the satellite states be placed squarely upon the Soviet Union; and that future credits to Eastern Europe become linked to the total range of issues presently under negotiation with the Soviet Union, possibly even with arms limitations.

I believe the issue of the Polish debt is a critical issue both insofar as East-West relationships are concerned, but also insofar as our relationships with our European allies are concerned. It is also an issue that will not go away. Rescheduling overdue debts as they mature, does not solve anything; paying off government guarantees will only buy some time. New credits will be required, further debts will mature. Sooner or later, the issue has to be faced.

As in every issue in which important commercial and political interests are at stake, the arguments being made for or against calling a default on the Polish loans tend to be highly emotional and rather one sided. That is quite understandable; a great deal is at stake here. In this case, however, where I believe the national interest to be served by a declaration of Polish bankruptcy, I also believe such a bankruptcy need not be inimical either to our commercial interests or to our allies. I have not seen such an argument developed so far.

There is a bad argument being made for the bankruptcy of Poland: namely, to show the world how tough we are. I do not subscribe to this reasoning. This is too important an issue for posturing.

At the same time, there are four main lines of arguments being made against a Polish default. They are: (a) That it would endanger the Western banking system, especially the German banks, because of the level of exposure; (b) That it would impair our relationship with our European allies because of the importance of their trade with Eastern Europe; (c) That Poland has no assets worth seizing and that a default, far from putting pressure on Poland or the Soviet Union, would actually relieve them of any obligation to repay; (d) That rolling over the Polish debt will show friendship and compassion toward the Polish nation while the opposite will drive it back into the arms of the Soviet Union.

I believe these arguments do not stand up to scrutiny. I believe such scrutiny is necessary not only because the Polish situation will not go away, but because soon, it will be followed by Romania and possibly, later, by other Communist states.

I have been asked, again and again, to justify my position on Poland in the light of my very public, very consistent and ultimately successful argument against a bankruptcy of New York City. The answer has nothing really to do with my emotional involvement with New York City, and the lack of a similar involvement with Poland, although like all Americans, I sympathize with the sufferings of the Polish people. My reasons are quite unemotional and they go to the heart of the problem.

The reason I opposed bankruptcy for NYC was my belief that we could, with limited help from the Government, provide significant new credits for the revitalization of the city, bring its budget into balance by the imposition of outside spending controls together with a growing economy, and obtain some level of sacrifice from all the various constituencies we were dealing with at the local level. That was the justification for our struggle of 1975–76, and that, with your considerable help, turned out to be correct.

ECONOMIC AND SOCIAL SHAMBLES

The situation in Poland is quite the opposite. Poland is an economic and social shambles. If the Polish debt had been public debt—with a trustee for the protection of the bondholders—instead of private debt, held by banks and governments, Poland would have been declared bankrupt long ago. The fact is that Poland is bankrupt, unable to meet its obligations when they come due, without any visible hope of meeting them in the future without massive additional new debt.

The Deputy Foreign Minister of Poland, Mr. Rakowski, recently stated that Poland would require $1.5 billion of new external credit every quarter of this year, or a total of an additional $6 billion in 1982. These numbers are usually underestimated; it is probably safe to assume Poland will require a minimum of $15 to $20 billion in additional credits over the next 2 to 3 years. It is pointless to speak of any repayments of past debt—principal or interest—without asking where the new credits will come from, and what kind of controls will be required to make them commercially viable.

It is perfectly obvious, looking at the economic shambles that is Poland today, that any new credits, to be viable, would require the imposition of economic hardships on the Polish people of a very high order. Strict budgetary austerity, increased production quotas on coal and agriculture, longer work hours in factories, lower subsidies and higher prices, in short, rolling back many if not all the economic benefits hard won by Solidarity, would be required at a minimum, from a purely commercial point of view. Not only is it probably impossible to enforce such controls, were we of a mind to do so, but I submit that neither Western banks nor Western governments should be put in the position of trying. We have only to think back to the 1920's when, through the Young and Dawes loans, we attempted to reschedule German reparation payments the German economy clearly could not afford, to see the dangers of a people turning against its creditors in frustration and hardships. The Polish Government controls its propaganda apparatus so that we will be damned if we declare default, and we will also be damned if we provide new credits with strict controls; this is an unavoidable dilemna.

The only other alternative would be to make large, outright grants in exchange for political concessions the Polish Government could probably not deliver on if it made them, or would renege upon later on. I do not believe we should embark on a program of massive grants to Poland; we have too little to gain from such a course of action.

It is because I believe new credits to be out of the question, under present circumstances, that I believe that bankruptcy becomes self-evident.

We now come to the issue of the possible danger to Western banks. As reported in the press, the exposure of U.S. banks, although not inconsiderable, is clearly within the capacity of the banks to handle. A total of $1.2 billion is reportedly owed to U.S. banks, with the largest credits to individual banks, in the area of $100 to $125 million. Our largest banks are well able to handle even total writeoffs of that size which I am incidentally not advocating, and many must have already provided considerable reserves for such contingencies.

The real problem seems to be the German banks, whose exposure is, however, partly guaranteed by the German Government. Press reports indicate total exposure of German banks to be about $6 billion of which 40 to 50 percent would be government-guaranteed, for a net exposure of $3 to $3.5 billion spread over 100 banks. The largest individual exposure seems to be of the order of $420 million of which $340 million would be without guarantees.

Again, let us look at the reality of this situation. A bank problem occurs in two areas: liquidity and net capital. One is cash, the other is accounting. The German banks clearly have no liquidity problem since the Polish loans are already not providing either interest or principal repayment; furthermore, any potential liquidity problem can be handled easily by the German Central Bank just as equivalent problems can be handled by the Federal Reserve Bank here. Therefore, we are talking about net capital or essentially accounting problems. Large writeoffs or additional reserves would impair the banks stated capital, reduce earnings and possibly eliminate dividends for some time. But the fact of the matter is that the Polish loans already are bad loans; declaring Poland in default will not make them worse. I shall revert to this subject in due course since I believe the so-called bank problems can be handled rather easily; I do not believe, however, that accounting fictions should dictate our foreign policy.

The issue of trade with Eastern Europe seems to me also to be devoid of reality. Trade with Eastern Europe requires Western Europe to provide large commercial credits. These are already drying up as a result of the uncertainty created by the Polish situation, the forthcoming problems of Romania's credits, and even the possible questions with respect to the Soviet Union's creditworthiness. In fact, an argument against a Polish default has been made to the effect that we already have some of the effects as a result of the existing sharp curtailment of credit to Eastern Europe.

The last, and least intellectually plausible argument, goes to the issue of "Friendship to the Polish People." Poland is, and will continue to be within the Soviet bloc as long as she remains geographically caught between Russia and East Germany. We are not going to liberate her, unless we try to do so by force of arms, with credits, slogans, friendship or anything else. A decade of détente and $25 billion of Western credits have not moved Poland out of the Soviet orbit; that should have taught us something.

What, in the last analysis, does logic dictate?

One. We should recognize that the availability of large scale credit facilities is a strategic weapon, fully as effective in terms of leverage, as military hardware. Large scale credits are probably the one major item the United States can withhold which the Soviet Union cannot obtain anywhere else. Grain and most technology can almost always be purchased. In a world increasingly short of capital, credit is harder and harder to obtain.

Two. The Wall Street Journal, using Wharton economic forecasts, estimated recently that the Soviet bloc's requirements for dollar credits would increase from a level of $70 billion at the end of 1980 to as much as $140 billion by 1985. Of this increase, Poland would account for about $15 billion, Romania about $10 billion and the Soviet Union about $25 billion.

Three. The Soviet Union is presently selling gold to raise foreign exchange and asking its Western suppliers for extended credit terms. If the West refuses to provide further credits to Eastern Europe, the Soviet Union will have to do so. Clearly those Soviet credits will not be used to repay all of the defaulted Western loans, but they will put great additional economic pressure on the Soviet Union at a time when its own economy is faltering, and the burden of defense spending and overseas commitments must be heavy. An additional external requirement of $70 billion on the Soviet bloc will have to be met by retrenchment somewhere else—possibly armaments—or by a recognition that accommodation with the West is preferable.

CREDITS HANDLED BY CENTRAL BANKS

All this seems to me to point to the notion that credits to Eastern Europe should be handled on a government to government basis as part of our strategic dialog with the Soviet Union. Whether that means licensing loans on a case-by-case basis as we license sales of strategic goods, or whether the credits should simply be between central banks—which I would prefer—is a detail. Furthermore, it would seem reasonable to suggest that we would only be willing to provide new credits to the Soviet bloc as part of overall negotiations with the Soviet Union and as participants in an economic recovery plan for Eastern Europe to which the Soviet Union would contribute at a minimum twice what we contribute.

To set the stage for such a dialog, the existing Polish debt in the hands of commercial banks should be acquired by their respective central banks at some discount from the face amount, say 50 percent, with final determination deferred until a plan of reorganization is worked out with the creditor state or states. The banks would get immediate cash, which would improve their liquidity, be able to take tax credits for recognition of the loss, and, to the extent their balance sheets required it, could be permitted to defer some of their losses until a final accounting takes place. That would solve the bank problem. It is not without cost, but then these loans were never without risk. The Western governments could then, on a coordinated basis, declare Poland in default and cut off additional credits to Eastern Europe. Simultaneously, the West could offer to participate in Soviet efforts to refinance Eastern Europe, but only if such refinancing were linked to other matters under present negotiation. It could, for instance, be linked to mutual reductions in the level of defense spending which neither country can really afford. The Soviet Union may reject this proposal initially, but sooner or later, it will have to come to us.

In summary, I believe that the question of whether to declare a Polish default is a misnomer. Poland is bankrupt and has been for some time. The real issue is not the reality of its bankruptcy, but whether we are willing to provide additional credits not only to Poland, but to the rest of Eastern Europe. I believe the answer to that question should be in the negative since we have been relieving the Soviet Union of an immense economic burden and possibly even providing indirect financing to Russia at no cost to its credit. I believe credit to Eastern Europe should be negotiated with the Soviet Union, and linked to other issues; the argument that this would reduce the satellites' independence from Russia is spurious. There is no such independence, and neither the Polish nor any other Eastern European government can be considered a viable, independent negotiating partner in such endeavors. In addition, although I usually do not favor symbolic gestures, I believe there is a symbolic value in the actual bankruptcy of a major Communist state vis-a-vis the rest of the world; if necessary, it should be followed by Romania and any other Soviet satellite unable to meet its financial commitments.

CREDITORS BECOME PRISONERS OF DEBTORS

Providing too much credit on excessively lenient terms does nobody any good. The New York financial crisis was partly due to such excesses. This has clearly been the case with Poland and Eastern Europe as a whole. Beyond a certain level, the creditors become the prisoners of the debtor nations; we may already have reached that level in other cases. A Polish bankruptcy can be effected without endangering the Western banking system, although it will carry considerable cost, if appropriately prepared by our respective central banks. The alternatives would ultimately be far costlier and give us far less leverage in the overall negotiations that will ultimately have to take place with the Soviet Union. Such negotiations from a position of strength may provide our best practical road to help the peoples of Eastern Europe, restore the possibility of East-West trade on a rational basis, and serve our best interests at home.

The CHAIRMAN. Thank you very much, Mr. Rohatyn.

Mr. Petty, if you wouldn't mind, I'd like to hear from Senator Kasten at this time.

STATEMENT OF ROBERT W. KASTEN, U.S. SENATOR FROM WISCONSIN

Senator KASTEN. Thank you, Mr. Chairman, and I thank you, Mr. Petty, for allowing me to go before you.

Mr. Chairman and members of the committee, I appreciate this opportunity to speak before you on the Polish debt crisis. Two weeks ago, the Senate came within nine votes of acknowledging Polish default on loans from the West. That was only the opening shot in what will be a continuing battle to cut off credit to the Polish military regime, to Eastern-bloc countries, and indirectly, to the Soviet Union. As chairman of the Foreign Operations Appropriations Subcommittee, I intend to continue hearings on the issue of Polish debt—the next hearing is scheduled for Tuesday, March 2. And I will continue to push this issue on the floor of the Senate, forcing a vote on default as often as is necessary to bring my point home.

Mr. Chairman, it's up to Congress to put backbone into our official reaction to martial law in Poland. Five thousand Poles have been detained without charge and without accounting. Martial law has been imposed, movement toward democracy has been crushed, and Stalinistic repression of the Polish people continues. The West has responded with a great deal of handwringing and a few ineffective trade sanctions.

BAILING OUT BANKS

Not only have we failed to take tough action on Poland, we are quietly bailing out the banks involved through an unusual, some say illegal, Commodity Credit Corporation procedure. The CCC plans to pay $71 million in February, and $876 million over the next 2 years, for Polish agricultural loans which are overdue to U.S. banks. The CCC's own rules and regulations require banks to first give a notice of default, which the Government must confirm, before any payment is made. These rules don't apply in the case of Poland. At least one independent legal foundation has already filed suit, protesting that these CCC payments cannot legally be made until default is declared.

But we must not allow ourselves to get bogged down in the details of default. Congress must decide after considering the real, underlying issue. For years, our trade and economic relationships with the Soviet-bloc countries have hardly been in our own best interest. The benefits of expanded trade with the West were supposed to be dependent upon Soviet good behavior. And the Soviet Union has certainly benefited by using its East European allies as a conduit for Western goods and technology—essentially forcing those countries to absorb the hard currency debts that the Soviets would otherwise be forced to pick up. When Poland's debt payments were stretched out in April of last year, Western creditors included a so-called tank clause, calling for default in the event of exceptional circumstances such as internal repression. Now that these exceptional circumstancess have occurred, the trade that was intended to bind East to West with hoops of gold is binding our own hands instead.

Some administration officials actually argue that by declaring Poland in default, we would cause financial havoc in the rest of Eastern Europe, which in turn would rain havoc upon Western financial institutions and governments. The inference is incredible—that we must continue to prop up the military government of Poland and the rest of Eastern Europe in order to save our own financial system.

Our seeming paralysis on the question of default just underscores our credibility crisis abroad. U.S. threats to use the economic measures available to us—to deny the East the benefits of trade—no longer carry any weight. They are not credible to our adversaries or to our allies. A declaration of Polish default would help restore that missing credibility. It would simply do what we said we would do—what all the Western creditors said they would do—under the exceptional circumstances clause of last April's debt rescheduling agreement.

In testimony before my Foreign Operations Appropriations Subcommittee, Assistant Secretary of State, Robert D. Hormats made it clear that "virtually all of the allies have agreed that technically the exceptional circumstances clause could be invoked" under current circumstances. And, Under Secretary of Defense Fred C. Ikle also said that:

> We had an agreement * * * in connection with rescheduling last year of the Polish loans, that they could be called up under exceptional circumstances. The definition of exceptional circumstances of course does fit the present repression in Poland.

A declaration of default would also aggravate the financial strains already apparent in the Soviet economy, and make it more difficult for the Russians to continue their unprecedented military buildup. Even though the Soviet gross national product is only 60 percent as large as ours, the Soviet investment in arms is much larger—exceeding U.S. investment by 80 to 90 percent during the last 5 years. As Under Secretary of Defense Fred C. Ikle testified before my subcommittee, this buildup occurred during the period called détente, and "this was also the period when East-West trade expanded and when the West gave increasingly accumulating credits to the Soviet economic system. By propping up the economies of the Soviet empire with Western credits, we make it easier for the Soviet Union to finance its military buildup."

Secretary Ikle stated that, if Poland is declared in default,

> The sky will not fall on the West. A limited but significant piece, though, may fall on the East. The pain in the West would be quite tolerable. It would be confined mainly to those financial institutions and traders who argued that we should extend a "carrot" to the East to induce good behavior, but who are now opposed to withdrawing this "carrot" when the behavior repeatedly is abominable.

RETURN FINANCIAL RESPONSIBILITY TO SOVIETS

American citizens are taxed twice for the Soviet military buildup: first, because the Soviet buildup necessitates an increase in our own defense budget, and a second time, when our Government subsidizes bad old loans and new loans to the Soviet bloc. It's time to put the financial responsibility for the Eastern-bloc nations back where it belongs—squarely on the Soviet Union.

More than 2 months have passed since martial law was imposed in Poland. The exceptional circumstances clause of the Polish debt rescheduling agreement has been met. The Polish Government is technically in default on loans to almost all of its creditors. What does America gain by this delay? The time to declare Poland in default is now. On February 10, 39 Senators backed the Moynihan-Kasten amendment to send that message to the administration.

Many years ago, Lenin predicted that capitalistic nations would fight amongst themselves to sell Russia the rope it would use to hang them. The Alliance must not let itself become so intimidated by the implications of a credit cutoff that it proves him right.

The CHAIRMAN. Thank you, Senator Kasten.

Mr. Petty.

STATEMENT OF JOHN PETTY, PRESIDENT, MARINE MIDLAND BANK, NEW YORK

Mr. PETTY. Mr. Chairman and members of the committee, my name is John Petty, and I am president of Marine Midland Bank, N.A. Quite independent of that responsibility, I am also president of the Foreign Bondholders Protective Council, a private body created years ago at the instigation of President Franklin Roosevelt, Cordell Hull, and Henry Morganthau. It was set up as a nonprofit, public service group to act as spokesman for holders of defaulted foreign bonds, issued in dollars and publicly offered in the United States. We eventually achieved a settlement on certain old debts with most of the Eastern bloc countries.

Today's hearing is a needed occasion to shed light on the issues associated with Poland's foreign indebtedness and the prospect of default. Our outrage over the decree of martial law last December 13 in Poland—and the outrage of people throughout the West—has, in my judgment, threatened to obscure how best to promote our national interest in dealing with Poland.

To declare Poland in default of her loans today would be nothing more than a symbolic gesture, a clenched fist of anger and frustration—and it could well incur costs quite contrary to our purposes.

What's involved here is whether the failure or delinquency of a country to repay its creditors can be turned into a lever by which a martial law decree can be reversed.

It's an absurd proposition.

BORROWERS GAIN LEVERAGE ON LENDERS

Poland's delinquency on its foreign loans gives us, unfortunately, no such lever. If anything, in fact, the reverse is true. For centuries lenders have known that what insolvent borrowers gain is leverage on the lenders themselves.

That, gentlemen, is the crux of the problem.

Yet, some newspaper stories would have you focus on other matters. For example, one story suggests that "when Poland defaults, it must make good on its debts before getting credit again." In fact, the truth is Poland's lenders did not wait for the niceties of a formal default before turning off the faucet. Whether a borrower is delinquent, in technical default, or with a formal declaration of default, these matters must be dealt with before any new credit is extended. In other words, the need for Poland to "make good" on its loans before receiving more credit fell into place some time ago.

Another story said, "Nor are we—the United States—trying to recover money. * * *"

And why not? What sense does that make, especially when the President announced recently that the administration is going after students, farmers, and other recipients to recover past-due loans? Are we going to leave $1.5 billion on the table in Warsaw?

Still another column, talking about the Commodity Credit Corporation's payment of loan guarantees to banks, suggested that "the payment was contrary to the law, which requires prior notice of default."

That, too, is incorrect. Let me give a little background.

Several decades ago it was judged to be in our national interest to sell our surplus agricultural products abroad. This generated jobs, personal income, and tax revenues at the same time that it moderated price fluctuations and reduced Federal loan and storage costs. The program has been generally applauded for years.

Perishable commodities such as wheat are normally sold on three-month terms, since that's the period required for transportation, distribution, processing, and consumption. However, the Commodity Credit Corporation, an arm of the U.S. Department of Agriculture, in an effort to foster new markets and expand sales, has regularly sold these products on 3-year terms, with some repayment each year. Among other things, the benefits of this approach include additional sales and reduced storage costs—which are no small sum—as well as less spoilage.

But it entails some risks: The CCC accepts credits private lenders are unprepared to make, namely, 3-year terms on perishables.

The CCC makes these loans directly or indirectly. They make indirect loans by guaranteeing sums put up by private banks. There is no way an experienced and sensible private lender will finance wheat shipments on 3-year terms except under a Government guaranteed export program. CCC guaranteed loans are U.S. Government risk loans, and are regarded and examined as such by banking supervisory authorities.

So what is all the commotion about? It's about a very arcane detail: Whether an unconditionally guaranteed party—the lender bank—gives notification of nonpayment to the guarantor—the CCC—and gets reimbursed; or whether the bank notifies the CCC of a nonpayment by Poland and then sends a message to Warsaw saying "by virtue of nonpayment, you are in default." At that point the guaranteed party—the bank—obtains reimbursement from the guarantor—the CCC. Actually, the CCC has the opportunity. It can declare default the moment it reimburses the lenders—or at a later date.

What difference does it make? It makes considerable difference.

Poland is near insolvency. It cannot meet all of its financial obligations on time. There is no economic program. Rule is achieved by the bayonet. The only law is martial.

DECLARING A SOVEREIGN NATION IN DEFAULT

But how do you declare a sovereign nation in default? When corporations go into default, the jurisdictional issue are relatively clear: Lenders may seize assets. They may sometimes even intervene right up to the point of management changes and control of financial operations. But how does this apply in a credible way when sovereign nations don't pay on time?

Nevertheless, it's been argued that under these circumstances, United States leverage in Poland will be increased, and that it will somehow be ever stronger if that letter is sent to Warsaw declaring a formal default.

What is the logic of that argument? It goes something like this:

First, if U.S. default clauses are invoked, non-U.S. lenders would have the option of declaring default themselves.

Second, if that happens, it would likely accelerate all of Poland's foreign debt obligations, making almost $27 billion due and payable immediately—whether or not Poland has the cash to do so.

Then, somehow, the argument assumes we can prevail upon Prime Minister Jarulzelski to relax martial law. One party even argues absurdly that not to declare default amounts to "tacit collaboration" with Jaruzelski.

Next, the presumption is that, because of the default, the Soviet Union will need to increase its assistance to Poland.

And finally, in order to meet Polish needs, the Soviets will have less cash to spend on their own homefront. Consequently, Moscow will have very hard choices to make at home, presumably of the guns or butter type. Ultimately, the argument concludes, the Soviet military will receive less money and be weaker as a result, or the Soviet people will be denied so severely they will finally rise up to lighten their despotic burden.

This scenario will never play.

Jarulzelski is not now, and has not been for some time, getting any new credits. So a formal declaration of default has no bearing on that matter.

Already credit to all other Eastern bloc nations has been sharply curtailed. There may be a few residual drips in the faucet, but the general flow has been interrupted.

Default also permits non-U.S. lenders to declare default themselves and accelerate all Polish obligations so that they're due forthwith. Such an act is optional; circumstances would dictate whether it is exercised. But if some creditors are anxiously attempting to seize assets and enhance their creditors' position, other lenders must also invoke default in order to exercise the same privilege. With nearly 100 private lenders in several countries involved, all with numerous overlapping credits, the legal complications—not to mention the various uncertain jurisdictions—simply boggle the mind.

And in any case, Poland doesn't have many material assets outside its borders.

So perhaps we should pause a minute and define our objectives.

Are we trying to end martial law in Poland? Default has no relevance.

Are we trying to end all lending to Poland, the Eastern bloc, and the Soviet Union? Default is an unsatisfactory device.

And if we want to go even further—if, indeed, it is our desire to have Poland repay as soon as possible, then how should we conduct ourselves to achieve that objective?

In 1981, all parties judged that Poland couldn't meet its principle payments, so we held her feet to the fire on interest payments. We said at least meet the interest payments, and we'll stretch out the principle payments due in 1981. This was an acknowledgement of reality, based on the sound belief that rescheduling debt is far preferable to some vague "Pay up when you can."

This was viewed as rational last year. It's still rational today.

How does the brutal enforcement of martial law in Poland last December 13 change all this? Certainly we're outraged by that tyrannical act. It was a crushing denial of freedom which turned back the clock on all the hopes nourished by the valiant men and women of Solidarity. With equal certainty, we're anxious to do nothing that would condone, or appear to condone, this violation of the Helsinki accords, this denial of basic human rights.

Default gives us no leverage to right that wrong. We can best serve ourselves and help the budget by obtaining payments and working with the other creditors to that end.

EFFECTS OF DECLARING A MORATORIUM

If one accepts the premise that declaring default yields no leverage on Jarulzelski's conduct, or the duration of martial law, or funding for the Soviet military apparatus, then declaring default at this time is nothing more than a symbolic gesture of frustration about the outrage in Warsaw. And it runs the serious danger of providing an opportunity, indeed, an excuse, to cause the borrower to declare a moratorium on paying interest as well as principle to U.S. lenders.

This is no idle risk. Such a moratorium might have two effects:

First, the repayment money that would benefit the U.S. Treasury, the taxpayer, the CCC and other lenders would be diverted to repay non-U.S. lenders. If the moratorium were total, our allies would suffer substantially more.

Second, there would be less of a call on the cash reserve of the Soviet Union and Poland to service their foreign loans, with the result that they could put that money to use shoring up their homefront.

Such a moratorium, however, would not jeopardize the viability of the international monetary system—troubled through it may be.

Still, I do not see how conduct that precipitates a moratorium would help our national interest.

But let's assume the wishful thinkers scenario plays out, the squeeze is put on the Soviet Union, forcing them to choose between arms for their soldiers and food for their people. But there will be no debate about guns versus butter.

What single event in Russian history would suggest their rulers' regard for the people's welfare would take precedence over the demand of the military? What in history—under the czars or under the Bolsheviks—would sustain such a hope?

U.S. policy can't be based on such wishful thinking that a few billion dollars will break the Soviet yoke on its people and somehow bring about a transformation of history. It would only place a double lock on the Iron Curtain. Such wishful thinking cannot be the stuff of realistic foreign policy.

Thank you.

The **Chairman**. Thank you very much, Mr. Petty.

There's no doubt that in this last panel we certainly have both sides represented. I did note one element of agreement, though, gentlemen. Both of you have had considerable experience in dealing with financial crises.

In your judgment, what are the possibilities of Poland having a sufficient economic recovery to ever repay the current debt that they have, forgetting any future credits?

NEW CREDIT PROGRAM FOR EASTERN EUROPE

Mr. **Rohatyn**. I don't think there's any, Mr. Chairman, as far as the eye can see. I believe it is utterly pointless to talk about any repayments by Poland on its existing debt without talking about a large new credit program for Eastern Europe, and I'm very unemotional about this.

I think we're going ultimately to have to talk about new credits to Eastern Europe if there's going to be any possibility of any repayments that are existing today. I don't believe we should participate in those discussions with the Polish Government or with the Romanian Government or any other government unless the Soviet Government is sitting at the table and making a participation because I think it's a needless extension of credit on our part indirectly to the Soviet Union at a time when credit is becoming a very scarce commodity and I just believe that it's one of the most basic rules of negotiation that you never negotiate with an agent, but you only negotiate with the principal, and I don't believe that the Polish Government is a principal in this. I don't believe that they can deliver and I don't believe that the conditions that we would set on any new credits to Poland are conditions, if they are commercially viable, that they could deliver on.

The CHAIRMAN. Mr. Petty, how do you feel about that?

Mr. PETTY. I think ever is a long time and over the long term I wouldn't exclude the possibility of servicing the debt. Certainly in the immediate 5-year period there's no possibility for them to service the principal on their debt. However, there is a definite possibility to service their interest on their debt.

But I think my difference with Mr. Rohatyn comes at a point beyond that. He refers to a need for ultimate long-term credit with Eastern Europe and we should negotiate it as a lever. I would agree with that. What disturbs me about the proposal of declaring default is that by doing it we are going to miss the real opportunity. The real opportunity is over time and with a lot of consultation with our allies and after reestablishment of human dignity in Poland and with the principals at the table, there could be restored economic intercourse. This prospect is a meaningful bargaining component to essential dialogs with the Soviets, perhaps as strategic arms reduction talks, but that to force default now, to bring thousands of lawyers, lawsuits, all within different legal jurisdictions, you would then not be able to unwind it, which is the problem we had with Iran. If you want the flexibility of negotiating in the medium term a type of economic dialogue with the Soviets, bargaining for increased intercourse, we cannot have everything all tied up in lawsuits, the administration without the flexibility to bargain. Default costs us money and it denies long-term flexibility for the long-term objective that I share with Mr. Rohatyn.

Mr. ROHATYN. If I could just make one additional point, Mr. Chairman. I think one of the real problems in this Polish situation is we keep confusing our commercial interests with our national policy interests. I would submit to you, Mr. Chairman, that if Poland had $3 or $4 billion in assets in the West that those assets would have been seized by the Western banks and Poland would have been declared in default 6 months ago, just as the Iranian assets were seized, and then you would hear a wholly different argument as to whether it's in the national interest to declare Poland in default and what happens if we do it.

NO REALITY TO REPAYMENT

It so happens there are no assets to be seized and therefore there is the a not-illogical argument in suggesting that there is an alternative to default which is to string this thing along. I happen to think it doesn't get us anyplace. Since there is no reality to repayment, we ought to face the issue, clean the table, and face the fact that this is a nation that is bankrupt, that it is in default. Bank loans are not forever, but there is such a thing as a maturity of a bank loan.

I would also submit to you, Mr. Chairman, that if bank regulators did their job and classified these loans earlier, we wouldn't have to be living an accounting fiction here. Our national interests keep getting mixed into issues of commercial interests. I don't want to hurt the banks and I don't want to hurt the Western banking system, but as I said earlier, I don't believe the Western banking system to be endangered here and I believe that we are not facing the reality of the situation.

I would suggest—and I would suggest putting it in the record—the London Economist last week wrote a very brilliant editorial on the issue of a Polish default. They and I come out somewhat differently. They walk up to the issue of default and want to threaten it if the Soviets don't agree with these conditions. The reason I would go the next step is I don't believe those conditions can be agreed to or else we will be strung along for years in the discussions. But the point they make is we now have the whip in hand in terms of credits and it will not really harm our banking system.

The CHAIRMAN. Mr. Petty, even if what you say is true, that this is only symbolic, can't that be an extremely important weapon in foreign policy? I think it can. I think we have made some mistakes over the years by not being more willing to use some of that symbolism that might impress a few people around the world rather than the symbolism of being weak and ineffective. Here I'm going far beyond credits into a lot of other areas, but isn't there some importance in symbolism?

Mr. PETTY. Senator, I think the symbolism is more at home. Overseas, the act would not be understood. It would be difficult for our European partners to understand why we are forgoing hundreds of millions of dollars of interest payments currently received. It may be difficult to understand at home why student loans are being pursued for collection with the money left on the table at Warsaw. So it has a lot of different cuts. In Eastern Europe it might mean provoking a moratorium and I believe this is a symbolism that might be viewed with a little bit of relief by them. Symbolism also is a kind of a fist of angry frustration. I'm afraid we're pushing on a string.

The CHAIRMAN. What's wrong with a clenched fist once in a while? Why haven't we had some angry frustration over the last 30 years? I mean, they're winning the battle, Mr. Petty.

Mr. PETTY. Well, clenched fists waved in daylight with nothing to strike or no results achieved, achieves nothing and impresses no one. Where we want to go—and that's what I was trying to develop—where we want to go down the road and what is important in our dialog with Eastern Europe—are our strategic arms reductions talks significant? If indeed they are, as I think they are, can't we then shape this issue into a bargaining element in that greater dialog? And I think Mr. Rohatyn may share some of that thinking. The question is how we get into developing this bargaining position. Denying credit? Indeed, that has been done. The question is, how we employ or marshall any new credits over the long term if, indeed, we want to do that; and I don't believe declaring default would permit us to do that very well.

The CHAIRMAN. Let me just ask one more question here. Is part of the crisis a failure on the part of Western banks to be sufficiently prudent in making those loans?

Mr. PETTY. I don't think there's a lender who's made a bad loan who didn't go back and say, "Gee, I wish I could do it all over again." The commercial bank carries the asset and tries to specialize in collecting the loans. We take the long view and work with the borrower for ultimate repayment. Many loans to soverign nations get repaid. I negotiated 2 years ago with Bulgaria for repayment of some old Kingdom of Bulgaria debt. So I don't say that we will never get repaid. Some people throw up their hands. This is what commercial banking is all about.

The CHAIRMAN. We haven't succeeded in collecting our World War II debts from the Soviet Union yet.

Mr. PETTY. That, sir, is a subject that I have a strong feeling about whether we have tried very hard. I have gone on record in public on that. I share your point, Mr. Chairman.

PROBLEMS DEALING WITH SATELLITE GOVERNMENTS

Mr. ROHATYN. Mr. Chairman, the point I wanted to make and I think the point you just touched on is a very critical issue, which is the ability of Western commercial banks to deal with Communist governments, the Soviet Union or others. I would guess the Soviet Union, being a principal, is probably more rational to deal with from the point of view of a Western bank than a satellite government that is truly not a principal. There is a question in my mind, and a very fundamental question, as to whether it's appropriate for Western commercial banks to get involved with lending to Eastern Europe because they wind up in the situation that they're in today: either they've paid credits on terms that they found out later were erroneous or they become the prisoners of these governments.

No. 2, I believe that in negotiating with the Soviet Union you negotiate from a position of escalating pressure. I believe Poland is not the end of the problem of credits to Eastern Europe. Romania will be the next country in line, not only to reschedule its old debt but to borrow new credit. And it seems to me that you can escalate this pressure, that you can have a Polish declaration of default, and for the moment not reschedule Romania and simply stand and wait and see if there is a negotiation with the Soviet Union. If there isn't, you take the next step. Sooner or later I'm convinced there has to be a negotiation with the Soviet Union because the Soviet Union. Although the Soviet Union I'm sure is not loathe to choose guns before butter, it would have to support the Eastern European countries at a much higher economic level than if we provide the future credit.

I think future credit is an inevitable part of this discussion. You cannot look at the Polish loans. They are gone. They have been finished. There is no possibility of repayment of these Polish loans unless you look at the issue of future credits, and it is when you go to that issue that I would just as soon separate the old commercial banking interests from the future of this exercise and start with a completely clean slate.

The CHAIRMAN. Well, I realize I'm a country Senator from a small State, but I'll guarantee you that my people have a hard time understanding why for several years they have had a difficult time getting a few thousand bucks for a mortgage loan or an automobile loan or whatever, and Western banks have been loaning massive amounts of money to Eastern European nations. I don't even try to explain it. It's not possible for me to explain that to them.

Mr. Petty, do you wish to respond once more or were you just resting?

Mr. PETTY. Well, a little bit of both, I guess. I'm disturbed by the fact that in declaring default we let Poland off the hook.

But second, I think getting to the issue of the ultimate long-term relation with Eastern Europe and the Soviet Union and credit in that context, that a point where I think we have to get—I differ with Mr. Rohatyn in thinking declaring default is going to help us get there. That's the fundamental point of difference.

I believe that when you get thousands of lawyers and several possible jurisdictions, you're never going to unravel it, and trying to unravel that type of issue without the Federal Government taking over—and again, that's a burden that I don't think the Government should take.

The CHAIRMAN. Well, I don't know what relationship student loans have to do with it. I was brought up by a father who taught me if you borrow money you were supposed to pay it back. So regardless of what's going on in Poland, I think students ought to pay back the loans that help them get educated. There are lots of students who got educated, including this one, through college when there weren't any student loan programs. We managed to get through, and now with the low interest rates on the student loans, that are supposed to be paid only after you have graduated from college. I see no excuse for not paying those loans back. But that is not the subject of these hearings today and, gentlemen, I have many more questions. Once again, we are going to have to submit them to you for your response in writing. I appreciate both of your spirited defense of your opposite positions.

Senator Moynihan is here and so we will submit some additional questions to you for your response and I'd like to call Senator Moynihan to the table.

STATEMENT OF DANIEL PATRICK MOYNIHAN, U.S. SENATOR FROM NEW YORK

Senator MOYNIHAN. Mr. Chairman, you are very kind to ask me to join this distinguished company. I hope I can be of some help to the committee on a question which has been dealt with, but regarding which I have some further information: What would be the consequence to the United States or the Commodity Credit Corporation if they followed their routine and required a lender to declare a debt to be in default before applying for the payments of Commodity Credit Corporation insurance?

This is another question, as you know, which is of some importance regarding the legality of the change in administrative procedures that took place with respect to the Polish debt.

CONSEQUENCES FOR AMERICAN BANKS

Clearly, the law requires that, if the regulation requiring default was to be changed it should, at minimum, have been published in the Federal Register.

But let's go to the question of what would be the consequences for Americans and for American banks.

Last Thursday, the President held a press conference and regarding this matter said: "Default literally is like bankruptcy and they're absolved of their debts."

Now following the Senate debate on an amendment that Senator Kasten and I introduced 2 weeks ago, we asked the Congressional Research Service at the Library of Congress to advise us on this very question. I have a CRS report which I would submit for the record if I may.

Its title is: "Effect of Default or Proposed Repurchase of Polish Obligations," and the key paragraph says simply this:

> Until such time as a settlement of obligations is realized, whether by proceedings before the International Court of Justice, foreign claims commission, agreement (executive agreement or treaty), arbitration or conciliation, we know of no legal theory which would absolve Poland of liability for debts incurred in connection with its purchase of agricultural commodities whose payment is assured or guaranteed by the CCC.

They are not absolved from their debts in any way. It is not like bankruptcy. A declaration of default is simply a matter of giving banks certain options. And banks exercise those options, as I understand, on the basis of what are the advantages.

The situation was admitedly different when Iran defaulted and there were $6 billion worth of Iranian assets in banks in the West. There are no Polish assets lying around and so the banks are reluctant to declare default.

The results of default would be minimal in that sense. But the issue is not so much the immediate consequences of default, but the consequences of our going to such extraordinary lengths to avoid it. Here I would just like to read you one line by Lenin on the subject which has been authenticated—it's one of the few that has been. I will preface it with a brief explanation.

SOVIET PROPHECIES

To an extraordinary degree, the rulers of the Soviet Union are people who live by certain prophecies about the way the world is going to behave. An awful lot of those prophecies have been pretty well disproven, and only a few remain. One of those that remains is a revision of an earlier prophecy. Marx, in 1859, published his book, "Das Kapital". It was written not called "Socialism" or "Communism" or "Happiness" or "National Urban Planning." It was entitled "Das Kapital," and it was about capital. He said the West is going to enjoy this wonderful industrial revolution but there will be limits. Why are there limits? Because there is overproduction in capitalist societies and as they overproduce, the rate of return to capital will decline. As capital declines, they will try to hold up as best they can by sweating production from labor in one form or another. They will cut wages and extend the hours. It won't work in the end and capitalist society will crash. Sixty years later, in Lenin day, it hadn't crashed and Lenin so wrote the first great revision of Marx. He said—his book was called, "Imperialism"—that through imperialism capitalism had temporarily put off the still-inevitable collapse. It had got all these new markets. It's very hard to explain to a Third World Ambassador that according to Lenin's theory, the reason that Britain conquered the Punjab is because they had dumped on them all their railroad trains they didn't need any more. But, that's what Lenin had understood very early on and that is what he wrote.

Then Lenin in power said, "We are their last outlet". Although things looked pretty glum along about 1920 and 1921, he said "Don't worry. They will come to our rescue because they have no choice. My theory proves it."

Here's the statement:

> The capitalists of the world and their governments in their rush to conquer the Soviet market will close their eyes to the activity of the various Soviet subversive activities elsewhere and they will thereby be turned into blind deaf mutes. They will furnish support for the communist parties in their countries and by supplying us materials and technical equipment which we lack will restore our military industry necessary for future attacks against our suppliers. To put it in other words, they will work on the preparation of their own suicide.

Now the point is that's the only prophecy these people have intact. We have a huge surplus of wheat. We've got to get rid of it. We give it to them, even lend them the money with which to buy it. We have a huge surplus of pipe-laying equipment. We give it to them and lend them the money to buy it. We do all these things and then they break our rules of banking, and it doesn't matter. We fix up the rules because we have no choice.

Now, in fact, we have many choices, but they don't know it. We are a pretty strange country to them and all they know is what Lenin said. When we confirm his prediction, that's when we come to the real heart of this. I mean, if we shipped them a division of M-1 tanks, it wouldn't have the same consequences. The collapsing society is a society acting just the way they thought it would.

We're not a very theoretical bunch of people in the Senate, but they are a very theoretical bunch in the Politburo and they know these texts and we shouldn't confirm these texts and we do so at great peril. It also encourages them.

Mr. Chairman, I won't keep you. I would ask permission to include a statement of mine which I prepared for today's hearing and the Congressional Research Service paper to which I have referred.

The CHAIRMAN. We would be happy to put them in the record.

[The additional information received for the record follows:]

STATEMENT OF SENATOR MOYNIHAN

Mr. Chairman, members of the Banking Committee: Thank you for permitting me this opportunity to testify today about American policy toward Poland and the Soviet Union in the wake of the Soviet-guided repression of Solidarity, Poland's free trade union.

I imagine it will come as no surprise to you when I say that I have been profoundly disappointed by the failure of the United States Government to put in place a coherent and effective response to the suppression of civil liberties and human rights in Poland. Ten weeks have now passed since the imposition of martial law in Poland and the brutal suppression of Solidarity, and still the United States and its allies have not found a way to apply meaningful pressure on either the junta in Warsaw or its masters in Moscow to mitigate or end this repression. Arrests and imprisonments of thousands of Solidarity members continue; show trials and summary judgments are the order of the day in the Polish People's Republic; Lech Welesa remains in confinement.

What have we in the West done about the violent disruption of a peaceful, popularly-supported process of democratization in Poland? The United States, taking a harder line on this than its allies, has suspended landing rights in this country for the Polish national airline and produced a television spectacular.

Yet there continues to exist a possibility that the West will begin to address this matter in a serious manner. The President and the Secretary of State, and other leaders of the Western alliance, have repeatedly said they will impose harsher sanctions if the situation in Poland does not improve. We are in the eleventh week; the situation has not improved. It is time to take the next step. I believe default should be the next step.

A declaration of default would add to the financial and economic pressure on the Polish junta and on the Soviets who helped to install it. In the continuing absence of the political and economic reforms in Poland that are our goals—and which, if they were to occur, should mean that we would reconsider—default would render impossible any commerce by Poland with the West and make more difficult any trade by the Soviet Union. In the United States, for instance, the Johnson Act regarding financial transactions with other countries, enacted by the 80th Congress in 1948, makes it a criminal offense for Americans to lend money to a foreign government or its agents "while such government, political subdivision, organization or association, is in default in the payment of its obligations, or any part thereof, to the United States."

The economic pressure that default would bring to bear would be of the most effective kind, for any effort to resuscitate the moribund Polish economy must require loans and credits from the West. Poland needs manufactured goods that simply cannot be produced in sufficient quantity in eastern Europe. And Poland cannot now afford to purchase these goods without financial assistance from the West. While the United States should provide that assistance for as long as the government in Poland is responding to the humanitarian and political needs of its people, I do not believe the U.S. should provide such assistance in the present circumstances. For as long as we do, we will only be seen by the Polish people themselves to be abetting their military rulers.

Today's hearings are quite properly devoted to an examination of the effect that such a declaration of default would have on the American institutions involved. Is it true, as some have said, that the western economic system would be thrown irrevocably into ruin by a declaration of default? My own discussions of this with bankers in New York have persuaded me that this is not the case. The Committee's investigation will hopefully shed additional light on the situation.

For my part, I will address two specific questions and then offer a comment about the broader issue with which we are dealing here.

My first point pertains to the issue of absolution. When I testified to the Foreign Operations Subcommittee of the Appropriations Committee two weeks ago on this subject I noted that a number of Administration spokesmen had indicated that a declaration of default would somehow absolve Poland of all future obligations to pay its debts to the West. "That is not true," I said. "Default is not the international equivalent of bankruptcy for an individual or corporation, wherein an overextended borrower can be relieved of the obligation to pay some or all of its debts through the filing of bankruptcy papers."

Two weeks ago I thought simply that I was setting the record straight. This is a complicated matter, and many of the people in the State Department and at the White House who have been dealing with the situation in Poland are not bankers. I am not; but I do know this much about default: it is not the equivalent of bankruptcy. Yet the Administration continues to say that it is, as a large part of the argument against proposals to declare Poland to be in default.

Last Thursday, President Reagan said at his nationally televised press conference: "Default literally is like bankruptcy and they're absolved of their debts."

The Secretary of State has made very similar statements numerous times in the past few weeks. And yet what they are saying is not true. One begins to wonder whether there is a deliberate policy in place somewhere in the government to obscure this point. Clearly the President has been given erroneous information.

Afraid that this issue might become a matter of some controversy, I last week requested the Congressional Research Service at the Library of Congress to investigate this very question. I asked: Would Poland be absolved of its debts if American banks or the United States declared Poland to be in default? The conclusion, in the form of a report from the Library's Senior Specialist in American Law, after consultation with experts in international law, was that:

"Until such time as a settlement of obligations is realized, whether by proceedings before the International Court of Justice (ICJ), foreign claims commission, agreement (executive agreement or treaty), arbitration or conciliation, we know of no legal theory which would absolve Poland of liability for debts incurred in connection with its purchase of agricultural commodities whose payment is assured or guaranteed by the CCC. Cf. inconsistent practice regarding obligation of a successor state to pay debts of its predecessor. In the absence of an agreement to the contrary or mutually acceptable settlement, neither present inability to pay nor a change in the holder of the underlying contract obligation to pay, has any absolving consequence relative to such obligation".

Later in the report, which I attach as an appendix to my testimony, the following conclusion is stated:

"In summary, Poland's legal obligation to pay its debts continues the same with any obligor in default until settlement or other resolution of the contract terms is worked out with the parties. * * * While Poland could attempt, as other nations have attempted in the past, to renounce its debt and walk away from its legal obligations, such action would come at a price, namely, impairing its credit worthiness in future business arrangements not only in the U.S. but in the West, generally, and submitting itself to retaliatory actions."

I will not dwell much longer on the point. Default is not the moral equivalent of bankruptcy or any similar such thing. A declaration of default would entitle creditors to "accelerate" the loan and demand that the entire loan be paid immediately. Because of cross-default provisions in most loan contracts, virtually all of Poland's debts would come due immediately and creditors would be entitled to seize what real assets might be available in partial satisfaction. Poland would still be responsible for the remainder of its debt, and would have to pay it before it was able to borrow any more money, or obtain trade credits from the United States. It would also mean that the U.S. Government through various of its agencies, would buy the guaranteed portion of the Polish debt, thus, concentrating it in the hands of the Government.

The second specific point that I would make, and I will be briefer here, concerns the specific manner in which the U.S. Government has changed its policy regarding payment of overdue guaranteed Polish loans and credits. The Library of Congress report to which I have referred suggests that the Administration has violated law with respect to changes in departmental regulations. "Current regulations make it appear that payment by the CCC is conditioned upon receipt of notice of default." These regulations have not been changed. A section of the Administrative Procedure Act (APA) permits the agency "for good cause" to dispense with notice and public comment requirements when altering a regulation when they are "impracticable, unnecessary, or contrary to the public interest." Completely outside the rule-making requirements, however, are "foreign affairs functions of the United States." Yet, as the Library states: "we have received no indication of any intent by the Department of Agriculture or the CCC to either comply with the rule-making requirements of the APA or invoke its foreign affairs exemption or 'good cause' exception."

I will simply raise the question of whether the Congress should abide in these violations of the law.

I said a moment ago that the effect of a declaration of default would be to concentrate the Polish debt in the hands of the U.S. Government. This, I believe is where it belongs. Trade with eastern Europe is strategically significant at least as much as it is commercially important, and it is to our disadvantage to disregard this.

The policy of detente, after all, which had been pursued by three administrations during the 1970's had as its objective the creation of precisely such a condition of indebtedness to the West by the Soviet bloc. The policy was to lure the eastern Europeans, and the Soviets themselves, into an ever-larger network of interlocking trading relations. We would loan them vast sums of money, they would use it to buy from us food and machinery—and would soon become dependent on the West for their sustenance. They would be reluctant to disrupt the network thus established, and so would behave in ways more acceptable to the democracies. They would not invade other countries, they would not be so bold in the brutalizing of their own people. Because they would be afraid that we would cut off the trade, call in the debt, end the credits.

What has happened? Afghanistan teaches us one lesson. The suppression of Solidarity another. We have found ourselves hostage to the very trade relations we established in order to capture the Communist states.

Before we continue very much further along this path, before we lend any more money, before we pay Poland's debts, I believe we should determine what is our policy. If we are unwilling or unable to use the trading relationship to our political advantage in the circumstances in which we now find ourselves—Poland unable to pay its debts, Solidarity disbanded and its leaders in jail—then in what circumstances will we ever use it?

Congressional Research Service,
The Library of Congress,
Washington, D.C., February 18, 1982.

To: Hon. Daniel P. Moynihan.
From: American Law Division.
Subject: Effect of default or proposed repurchase of Polish obligations.

Reference is made to your recent inquiry requesting information on the above matter. Specifically, you ask whether the State of Poland will continue to be an obligor in the event the proposed repurchase agreement is consummated or Poland is declared to be in default pursuant to Commodity Credit Corporation (CCC) regulations governing Noncommercial Risk Assurance Program and Export Credit Guarantee Program. 7 C.F.R. § 1487.1 et seq. and § 1493.1 et seq.

Until such time as a settlement of obligations is realized, whether by proceedings before the International Court of Justice (ICJ), foreign claims commission, agreement (executive agreement or treaty), arbitration or conciliation, we know of no legal theory which would absolve Poland of liability for debts incurred in connection with its purchase of agricultural commodities whose payment is assured or guaranteed by the CCC. Cf. inconsistent practice regarding obligation of a successor state to pay debts of its predecessor. In the absence of an agreement to the contrary or mutually acceptable settlement, neither present inability to pay nor a change in the holder of the underlying contract obligation to pay, has any absolving consequence relative to such obligation. (The United States and Poland have longstanding treaties to arbitrate and conciliate differences which cannot be adjusted by diplomacy. 11 Bevans 218, 221.)

CCC regulations and the terms of the proposed repurchase agreement to all holders of assurance agreements and payment guarantees covering credits to Poland presuppose the continuation of the underlying obligation. In respect to CCC payment of a claim in connection with an assurance agreement—defined as "the written agreement under which the CCC undertakes . . . to protect the exporter or assignee from default by a foreign bank caused by noncommercial risks under the foreign bank's letter of credit supporting the exporter's credit sales contract or under the foreign bank's related obligation under its letter of credit to the exporter," 7 C.F.R. § 1487.2(c)—the CCC as surety assumes the rights of the exporter or his assignee. Thus, the CCC regulations relating to payment of loss and recovery of loss, provide, in pertinent part, that—

§ 1487.9 * * *

"(d) If CCC determines that it is liable to the exporter and/or his assignee, the exporter and/or his assignee shall execute and submit to CCC an instrument, in form and substance satisfactory to CCC, *subrogating* to CCC their respective rights for the amount of payment in default under the applicable export credit sale. After receipt of an instrument of *subrogation*, CCC will remit the amount of the loss plus interest, at the Federal Reserve Bank of New York discount rate in effect on the date of default beginning with the 31st day after notice of default was received by CCC and continuing to the date payment is made by CCC.

"(e) Upon payment of a claim to the exporter or his assignee, the exporter or his assignee shall cooperate with CCC to effect *recoveries* from the foreign bank and/or the importer. (Emphasis added.)"

§ 1487.10

"(a) Upon payment of loss to the exporter or his assignee, CCC will notify the importer and/or the foreign bank of its rights under the *subrogation* agreement to recover all monies in default." (Emphasis added.)

Similar provision is made in CCC regulations governing a payment guarantee—defined as "the written agreement under which CCC undertakes * * * to protect the exporter or the exporter's assignee from losses due to defaults in payment by a foreign bank under the foreign bank's letter of credit supporting the exporter's export credit sales contract or under the foreign bank's obligation owed to the assignee U.S. bank letter of credit issued in favor of the U.S. exporter, 7 C.F.R. § 1493.2(1)—under the Export Credit Guarantee Program. 7 C.F.R. §§ 1493.8(a)(iv), 1493.10(a).

The terms of the proposed repurchase agreement between the CCC and holders of assurances and payment guarantees covering credits to Poland likewise provide that the holders "must assign to CCC all right, title, and interest (including the right to charge interest in the rate provided in the credit for delinquent amounts) to the Polish obligor for the full amount of the corresponding payment * * *." 128 Cong. Rec. S614 (daily ed. 2/9/82).

In summary, Poland's legal obligation to pay its debts continues the same as with any obligor in default until settlement or other resolution of the contract terms is worked out by the parties. CCC regulations in this regard and the proposed repurchase plan do not operate as a forgiveness of the debt but simply affect a change in the holder, to all intents and purposes the United States. Assuming the accuracy of press accounts of Poland's apparent lack of reserves and its moribund economy and the asserted virtual nonexistence of Polish assets in the U.S., recovery of loss whether under the mentioned assurance agreements, payment guarantees, or repurchase plan in all likelihood will have to be resolved by future negotiations of the parties.

While Poland could attempt, as other nations have attempted in the past, to renounce its debt and walk away from its legal obligations, such action would come at a price, namely, impairing its credit worthiness in future business arrangements not only in the U.S. but in the West, generally, and submitting itself to retaliatory actions. See, for example, the so-called Hickenlooper Amendment to the Foreign Assistance Act of 1961, as amended, 22 U.S.C. § 2370(e).

The foregoing comments are directed solely to the question of Poland's continuing obligation to pay if it is declared to be in default or under the proposed repurchase agreement between the CCC and the banks. The CCC's authority to enter into such an agreement under its current regulations is another question. As to that question, current regulations make it appear that payment by the CCC is conditioned upon receipt of notice of default. 7 C.F.R. §§ 1487.8, 1487.9, 1493.9. In other words, there is no clear-cut authority in current regulations to pay holders to prevent their submitting notices of default.

As current procedures and requirements are matters defined by regulation pursuant to the statutory authority vested in the CCC, *inter alia,* to increase commercial exports of U.S. agricultural commodities, 15 U.S.C. § 714; 7 CFR §§ 1487.1, 1493.1(a), they are subject to change. "Certainly there is no constitutional requirement that the [economic regulatory] status quo be maintained." *North American Co.* v. *S.E.C.,* 327 U.S. 686, 708 n. 15 (1946). However, section 553 of the Administrative Procedure Act (APA), 5 U.S.C. § 553 sets forth notice and comment requirements for "rule making", which is defined in section 551(5) to mean "agency process for formulating, *amending,* or repealing a rule". Id. 551(5) (emphasis added). Section 553 (b)(B) permits "the agency for good cause" to dispense with notice and comment requirements when they are "impracticable, unnecessary, or contrary to the public interest." Id. § 553(b)(B). Completely outside the rule making requirements of section 553 are "foreign affairs functions of the United States." Id. § 553(a). As of this moment, we have seen no indication of any intent by the Department of Agriculture or the CCC to either comply with the rule making requirements of the APA or invoke its foreign affairs exemption or "good cause" exception.

Accordingly, leaving aside the possibility of complying with or obviating in the described manner section 553 of the APA, there seems little possibility in the existing regulatory framework for payment by the CCC in advance of compliance with the requirements of 7 C.F.R. §§ 1487.8, 1487.9, 1493.8 and 1493.9, relating to notice of defaults and payment of loss, respectively. The provision in CCC regulations to supplement by USDA announcements the Export Credit Guarantee Program is simply "to supplement", not to amend rules subject to APA rule making requirements. 7 C.F.R. §§ 1493.1(d), 1493.2(n).

RAYMOND J. CELADA,
Senior Specialist in American Public Law.

The CHAIRMAN. On that idea of shipping M-1 tanks, it might vastly damage their military capability. You may have hit on something there so that we can divert their military capability.

Thank you very much, Senator.

Gentlemen, we appreciate your testimony today. The Banking Committee will be adjourned.

[Whereupon, at 12:20 p.m., the hearing was adjourned.]

Report No. 82-25 E

SOVEREIGN DEBT: THE POLISH EXAMPLE

by
David D. Driscoll
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ABSTRACT

The external debt of Poland to Western governments and banks now stands at about $26 billion. The Polish Government's need to reschedule the debt and the threat of an outright default have raised questions about the international lending practices of Western banks. This report analyzes the reasons for the large exposure of Western banks in Poland and the effects of a possible default on the international banking system.

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SOVEREIGN DEBT: THE POLISH EXAMPLE

INTRODUCTION

The Polish debt of $26 billion owed to Western banks and governments has received considerable notoriety over the past few months and has raised serious questions about the conduct of international lending. Seth Lipsky, associate editor of the Wall Street Journal editorial page, suggests that some of the most famous names in U.S. banking were operating in ignorance in Poland, dispensing huge credits despite the enormous potential for political complication. How, he asks, could so many Western bankers manage to lend $17 billion of their depositors' funds on the basis of extremely limited information on the condition of the Polish economy? 1/ Not everybody agrees with Mr. Lipsky's criticism of the banking community, however, and there is evidence to suggest that Western bankers have had all along a fairly clear idea of economic conditions in Poland. U.S. bankers in particular appear to have exercised prudence and restraint in lending to Poland, as this report will indicate. This report is an attempt to suggest what went wrong with lending to Poland, the extent to which U.S. banks are exposed, and what effects a possible default will have on Poland and on the international banking system.

Although international lending is by no means an innovative banking activity, the crisis in Poland dramatically underscores new questions about

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1/ Lipsky, Seth. Bank Consortium Sends Questions to Poland. Wall Street Journal, November 19, 1981. p. 26.

the volume and concentration of such lending over the past two decades. To what extent are bankers acting responsibly in extending credit, often backed in part by their own governments' guarantees, particularly to Eastern bloc countries whose governments tend to operate in secret by including under the rubric of national security information Western banks disclose automatically? How valid is the conventional wisdom which regards a loan to a nation-state as a prime investment? What are the alternatives to declaring a defaulting nation bankrupt and attaching its assets abroad? The international banking community is now earnestly seeking answers to these and to similar questions about sovereign lending, but meanwhile the crisis in Poland continues unresolved.

II. FOREIGN LENDING BY U.S. BANKS

U.S. involvement in lending to Poland is only part of an enormous growth in international banking activity over the past two decades. The most significant measure of this activity is reflected in the data for foreign branches of U.S. banks. As Table 1 indicates, foreign branches of U.S. banks have experienced remarkable growth in number and in assets between 1965 and 1979.

Table 1: Foreign Branches of U.S. Banks

	U.S. Banks With Branches	Number of Branches	Total Assets of Overseas Branches (billions of dollars)
1965	13	211	9
1967	15	295	15
1969	53	459	35
1970	79	536	47
1971	91	583	60
1972	108	627	78
1973	122	697	122
1974	125	734	152
1975	126	762	177
1976	127	731	219
1977	124	730	259
1978	137	761	307
1979	139	779	364

Source: Korth, Christopher M. The Evolving Role of U.S. Banks in International Finance. Bankers Magazine, v. 13, July-August 1980. p. 69.

By the end of 1980, assets of these branches had grown to $400 billion and by August 1981 the total reached $433 billion. 2/ Moreover, income earned abroad as a percentage of total income of the 10 largest (by size of assets)

2/ Federal Reserve Bulletin, v. 7, November 1981. p. A56.

banking organizations in the United States rose from 17.5 percent in 1970 to 42.6 percent in 1979. 3/ Total foreign lending by U.S. banks, encompassing loans from both domestic and foreign offices, reached about $500 billion in 1979. 4/

3/ Guttentag, Jack and Richard Herring. Financial Disorder and International Banking. (Preliminary draft, dated March 18, 1981). p. 2-2. The U.S. bank holding companies included are: Citicorp, Chase Manhattan, Bankamerica, Manufacturers Hanover, J.P. Morgan , Chemical, Bankers Trust, First Chicago, Continental Illinois, and Security Pacific.

4/ Korth, Christohper M. The Evolving Role of U.S. Banks in International Finance. Bankers Magazine, v. 163, July-August 1980. p. 70. For further background on U.S. international banking, see: U.S. Library of Congress. Congressional Research Service. International Banking Facilities and the Eurocurrency Market. CRS Report, forthcoming, by William Jackson and Arlene Wilson. Washington 1982. Background Information on U.S. Export Trade Associations and the Separation of Banking and Commerce. Typed Report, by Raymond Ahearn and William Jackson. June 30, 1980. Washington, 1980. pp. 25-28.

III. RISK IN INTERNATIONAL LENDING

Because international lending is inherently more risky and considerably less regulated than domestic banking activity, it has been argued that growing internationalization enhances the possibility of a major shock to the banking system and at the same time impairs the capacity of the system to absorb such a shock. The potential adverse effect on the U.S. banking industry of foreign default on a massive scale has consequently become a matter of deep concern to the government and to the public. In the context of this possibility, why have U.S. banks assumed an aggregate foreign exposure of about half a trillion dollars in a market widely regarded as extraordinarily risky? The answer to this question lies in the overall expansion of U.S. trade, the spread of multinational corporations, the dampening effect of U.S. Government regulations on domestic earnings, and the lure of profit in financing trade deficits brought on by the unprecedented rise in energy prices over the past decade.

Until the late 1960s, two patterns of external financing predominated in international markets. One was short-term lending by commercial banks. The other was long-term financing by multilateral agencies (such as the World Bank) and by the export credit agencies (such as the Export-Import Bank) of the major capital-exporting countries. Trade financing for exports and imports, in which the disbursement of funds is tied to the actual shipment or delivery of goods or to the receipt of the relevant documentation (bills of lading, bankers' acceptances), was the principal short-term lending activity in the market dominated by commercial banks. Long-term international credits for infrastructural projects and for balance-of-payment adjustment were typically the domain of the World Bank, the International Monetary Fund, and multigovernmental regional banks. National export-credit institutions extended medium- and long-term credit to assist goods trade.

The invention of the Eurodollar roll-over credit in the late 1960s revolutionized this pattern by allowing commercial banks to become involved in a major expansion of long-term lending by transforming short-term deposit liabilities into long-term loan assets. To meet longer-term loan demands, commercial banks devised a system of rolling-over short-term deposits, that is, of offering the borrower an extended series of short-term advances automatically renewable at intervals, typically every six months. Since lending under these circumstances at a fixed rate of interest exposes the lending bank to the risk that a rise in deposit interest rates might render the whole loan unprofitable, the interest rate on the loan is floated or readjusted at each six-month renewal. This variable interest rate is a fixed spread over a base rate such as the London Interbank Offered Rate (LIBOR), the rate at which banks in London are prepared to lend to high-quality banks. 5/

During the early 1970s, commercial banks generally structured their Eurodollar credits as project credits, similar to those extended by the World Bank for projects which would ultimately produce income, but on shorter terms of 5 to 10 years rather than 10 years and more. After the 1973 oil crisis, however, commercial banks embarked on what some see as an unwarranted expansion of credit not tied to specific projects. The banks were responding to the traditional laws of supply and demand. Receipts of oil exporting countries de-

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5/ The interest rate on Eurocurrency loans is usually expressed as a spread or markup over LIBOR. The spread reflects the lender's appraisal of the default risk involved, the cost of servicing the loan, and the commitment period of the loan.

posited in Western banks provided a massive supply of credit waiting to be disbursed; simultaneously the demand for credit rose pari passu with the price of oil. Many of these credits, called balance-of-payment credits or structural adjustment loans, are obligations of sovereign governments by virtue of direct borrowing by the state, by government guarantee of the credit, or --in the case of Eastern-bloc countries--by state ownership of the means of production for which credit is granted. Since such loans are not tied to a specific project, the drawdown of the credit is typically at the discretion of the borrower and does not depend on satisfactory progress in the completion of the project.

Structural adjustment credits seem advantageous to both lender and borrower. Banks favor them because loans of this type transform project-related risks into country or sovereign risks. Such loans seem to obviate the necessity for detailed analysis of project feasibility: the sole criterion for the extension of the credit is the country's overall balance-of-payment and international-reserve position. The borrowing country welcomes these credits whose conditions afford greater flexibility in initiating and managing the liability. No longer must specific projects be justified in order to originate the loan; credits can be drawn down as needed and repaid out of foreign-exchange earnings from general exports rather than from revenues deriving from the success of a specific project.

IV. DEBT INDICATORS

In granting these loans banks came to rely increasingly on two broad categories of debt indicators. The first category measures a country's capacity for making repayment in convertible currency. The most widely employed of these indicators is the debt-service ratio, the annual interest and principal payments on aggregate long-term debt divided by annual earnings from the export of goods and services. The significance of the debt-service ratio as an indicator of capacity to repay is notoriously difficult to interpret: some countries experience no difficulty in handling a ratio of 40 percent and more; others have severe problems with a ratio of 10 percent. This paradox is explained by the degree of confidence banks have in the ability of a country to manage its debt. When confidence is high, banks are willing to roll over principal payments as long as interest payments are faithfully met. In such circumstances, the interest-service ratio--interest payments divided by the annual value of exports of goods and services--may be a better indicator of a country's ability to handle a loan since it avoids the distorting effects of bunching up repayment of the principal.

The second category of indicators is logically anterior to the first since it measures a country's capacity to generate the resources needed to acquire the foreign exchange to pay for imports and to service debt. The ratio of interest payments to Gross National Product (GNP) is the most common indicator in this category. Other indicators are the ratio of debt to foreign exchange reserves, the ratio of debt to the annual value of exports, and the capital-service ratio (annual contractual service payments on long-term debt plus repatriated profits on direct investment divided by the annual value of exports). Again, these indicators are difficult to interpret and do not move in parallel with one another.

The minimum requirement for the effective use of all these indicators is, however, precise and detailed statistics on the basic economy of a nation: a full disclosure of its debts, reserves, export capacity, and potential for earning foreign exchange. There is no substitute for detailed country analysis. Ideally, analysis should be based on information about a country's economic and financial management, such as evaluations of inflation, fiscal policies, trade and capital flows, debt accumulation, and political stability. Since all these variables cannot be captured in statistics (which in any case describe conditions as they were a year or two previously), it is inevitable that practical judgement and experience also come into play. Even then, predicting debt-servicing difficulties involves something of the crystal ball. 6/

6/ An excellent description of risk analysis is contained in Eichler, Gabriel. Country Risk Analysis and Bank Lending to Eastern Europe. In U.S. Congress. Joint Economic Committee. East European Economic Assessment. Joint Committee Print, 97th Cong., 1st sess. Part 2--Regional Assessments. Washington, U.S. Govt. Print. Off., 1981. p. 759-775.

V. EXPANSION OF UNTIED INTERNATIONAL CREDIT

Widespread extension of untied credit was given a boost by the series of oil price hikes beginning in 1973 as oil-importing countries scrambled for credit to readjust their skewed balances of payments, and banks, deluged with a flood of OPEC deposits, responded swiftly to the demand for credit. U.S. banks plunged into this market in 1974-76, followed by European and Japanese banks which rushed in to take advantage of the market just as the U.S. banks, began to grow more cautious about extending further credit.

Despite the generally successful record of repayment of government or government-guaranteed loans over the past two decades, 7/ sovereign debt involves creditors in special risks deriving from the unique mix of political, social, and economic institutions that characterize a sovereign state. Default can occur when a borrower fails to repay either the principal or the interest on a loan. The fundamental risk is, however, that a government's obligations to foreign banks are unenforceable. Because judgments of alien or international courts against a sovereign state can be enforced only if the creditor's government is willing to use force--a highly improbable contingency--virtually no legal recourse is available to attach sovereign assets for distribution among creditors. 8/

7/ Nonetheless, at least 16 nations have applied for rescheduling of loans from commercial banks over the past 25 years. Debt restructuring organized by the Paris Club--ad hoc meetings of representatives of the governments of creditor countries--has amounted to $5.1 billion since 1973. Of this sum, the rescheduling in 1979 of Turkey's debts to commercial banks accounted for $3.1 billion. International Bank for Reconstruction and Development. World Development Report 1981. Washington, 1981. p. 59.

8/ An exception is the attachment of the debtor country's aircraft, ships, bank accounts, and other assets which happen to be within the creditor's jurisdiction. Given the presumptive magnitude of outstanding debt, however, such assets are usually insignificant.

It has been calculated that, despite the inherent risk of foreign lending, prevailing spreads on Eurocurrency loans over LIBOR provide no significant compensation to banks that accept this risk. [9] How is it possible that risk premiums have been attenuated just when the possibility of default (deriving from, among other factors, the effects of the oil shock of 1979 and the present worldwide economic slowdown) has become more real? Perhaps the most significant subjective factor has been the nominal absence of defaults on foreign lending since the 1930s, a circumstance which has apparently lulled bankers into feeling defaults simply do not occur in the modern world. Objectively the realization that the system would be severely strained by a sovereign default has apparently induced bankers to continue lending to economically troubled countries at interest rates which are not so burdensome as to exacerbate the very condition they are intended to alleviate. Both these factors have contributed to the present crisis in Poland.

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[9] The weighted average of spreads of new loans to twenty countries in the last quarter of 1979 was 0.56 percent; that of loans to three communist countries was even less: 0.50 percent. Guttentag and Herring, Financial Disorders, pp. 217-18.

VI. LENDING TO POLAND

The balance of payments difficulty Poland is now experiencing reflects a complex interaction of political and economic forces that developed through a discernible pattern into the present crisis. Lawrence J. Brainard, chief economist for Bankers Trust Company, who has provided a valuable insider's view of the causes of Poland's difficulties, distinguishes several stages in the development of the crisis. 10/

A. The Policy Stage (1971 to 1975)

In 1971, the newly formed Gierek government embarked on an economic program of a distinctly populist nature, designed to achieve better living standards, accelerated economic growth (nurtured by imports of Western technology), and improved incentives for agriculture. By giving each social sector what it wanted the Government sought to gain for itself the legitimacy and political support subsequent events have shown it to lack. This strategy was, however, inconsistent with a realistic appreciation of the nation's economic strength, although at first, propelled by massive infusions of foreign investment capital between 1972 and 1975, industrial production rose over 10 percent a year, agricultural production achieved an average growth rate of 3.7 percent, and real wages managed an average annual rise of over 7 percent.

The problem soon to emerge was inconsistency in export policy. Although Bank Handlowy, the Polish foreign trade bank, had applied a self-financing rule to all loan requests, in practice this rule was ineffective because the

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10/ Brainard, Lawrence J. The Role of Commercial Banks in Balance of Payments Crises: the Cases of Peru and Poland. Unpublished manuscript, 1981.

Bank lacked the necessary economic expertise and political weight to challenge calculations made by ministries. The economy was thus opened to imports but lacked a mechanism to require ministries to pay for these imports through earnings from potential exports. Syndicated loans poured into the economy for a total of slightly under $2 billion between 1973 and 1976, at rates of 1/2 to 3/4 percent over LIBOR, indicating that Western bankers, ignoring the lack of data on Poland's economic resilience, had almost totally failed to take into account the risk element in these loans. 10/ Few credit syndications were associated with specific projects, and there were no follow-up reviews tying projects to export creation. Foreign banks had at this stage little or no influence over Polish economic goals.

Beneath the superficial success occasioned by the massive structural loan program, ominous signs of a troubled economy began to appear. Between 1971 and 1975, gross foreign debt rose from $1.1 billion to $8 billion, the proportion of loans guaranteed by Western governments fell from 63 percent to 18 percent of the total, the debt-service ratio nearly doubled from 12 percent to 23 percent, inflation worsened, and the current account went from a slightly positive position to a deficit of over $3 billion. Bank lending during this period was turning, apparently imperceptibly, pro-cyclical, that is, tending to amplify (rather than mitigate) the economic disequilibria generated by the regime's policies.

11/ The most creditworthy countries borrowed at this time at rates only slightly better: 3/8 percent over LIBOR.

TABLE 2. Polish Economic Indicators, 1971-80
(annual percentage changes)

	Industrial Output	Agricultural Output	Gross Fixed Capital Investment at Constant Prices	Cost of Living	Average Real Industrial Wage
1971	8.3	3.6	7.7	0.2	5.7
1972	10.7	8.4	23.7	0.0	6.4
1973	11.3	7.3	25.0	2.6	8.7
1974	12.5	1.6	22.5	6.8	6.6
1975	10.9	- 2.1	14.2	3.0	8.5
1976	9.3	- 1.1	2.2	4.7	3.9
1977	6.9	1.4	4.3	4.9	2.3
1978	4.9	4.2	1.6	8.7	- 2.7
1979	2.1	- 1.4	- 7.4	6.7	1.8
1980 (est.)	- 3.0	- 10.0	- 7.5	n.a.	n.a.

Source: Official Polish Data, quoted in Brainard, Lawrence. The Role of Commercial Banks in Balance of Payments Crises: the Cases of Peru and Poland. Unpublished manuscript, 1981.

E. Gathering Storm (1976 to 1978)

During the latter stages of the five-year plan that ran from 1971 to 1975, external stress began to aggravate the economy's internal weakness. A slump in coal prices 12/ and slackening demand for industrial goods because of the worldwide economic slowdown reduced export earnings of convertible currency. Instead of responding to these developments by gradually reducing the trade deficit with industrialized countries in a way that would not interrupt the transfer of Western technology, the Government drastically cut imports from the West in an across-the-board fashion, an action which endangered long-term prospects for development and reduced levels of output, including the output of exports on which the country relied for acquisition of foreign exchange. The result of this policy was consequently contrary to its intention: instead of putting the now-tottering economy on a firmer footing, it caused that economy to stumble.

Subsequent attempts to rationalize the economy and to improve investment efficiency by encouraging export industries proved futile. In June 1976, for example, the Government attempted to introduce substantial increases in the price of meat which had been uneconomically subsidized as part of the populist policies of the early 1970s. The Government had reasoned that the subsidy funds would be more effective if devoted to industries engaged in the production of goods for export. But the elimination of the meat subsidy evoked rioting in the major industrial cities and forced the Government to rescind this economically sound but politically unacceptable measure. Likewise, Government

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12/ The OPEC oil price hike in 1973 had temporarily improved Poland's terms of trade because heightened demand for alternative energy supplies had made Polish coal more attractive.

TABLE 3. Poland's Foreign Trade and Debt, 1970-80
Transactions in Convertible Currencies
(millions of dollars, percentages)

	Trade Balance ($ millions)	Current Account Balance ($ millions)	Gross Foreign Debt ($ millions)	Percentage Guaranteed by Lender's Government	Total Syndicated Credits ($ millions)	Debt-Service Ratio (percentage)	Debt-to-Export Ratio
1970	119	153					
1971	112	188	1,138	63.1	-		0.42
1972	- 265	- 134	1,564	45.2	-	12.0	0.50
1973	- 1,488	- 1,323	2,796	30.2	430	15.0	0.68
1974	- 2,167	- 2,204	4,643	22.8	508	18.8	0.86
1975	- 2,977	- 3,126	8,014	18.3	475	22.8	1.38
1976	- 2,952	- 3,223	11,483	20.2	525	33.9	1.94
1977	- 2,049	- 2,350	13,967	25.6	19	45.2	2.12
1978	- 1,883	- 2,461	17,844	24.7	374	61.4	2.40
1979	- 1,710	- 2,825	21,100	24.2	849	70.0	2.41
1980 (est.)	- 870	- 2,700	24,000	n.a.	800	85.9	2.37

Sources: Trade and current account, Bank Handlowy. Foreign debt, U.S. National Foreign Assessment Center. Syndicated debts, World Financial Markets (Morgan Guaranty Trust Co.). Debt service and debt-to-export ratios, Bankers Trust Company. Exports include service earnings. Computed by CRS from Brainard, Lawrence. The Role of Commercial Banks in Balance of Payments Crises: the Cases of Peru and Poland. Unpublished manuscript, 1981.

attempts to recentralize organization in the economy (which had been considerably decentralized in the populist reforms of the early 1970s) were frustrated by local and worker resistance, so the Government had to rely increasingly on *ad hoc* interventionist measures to control disequilibrium in the economy.

Statistical measures reflect this disequilibrium. The Polish current account deficit rose to well over $3 billion in both 1975 and 1976 and remained around $2.5 billion for the next four years. Gross foreign debt doubled from $8 billion in 1975 to $18 billion in 1978. Both the debt-service ratio (23 percent in 1975; 61 percent in 1978) 13/ and the net debt-to-export ratio (1.4 in 1975; 2.4 in 1978) 14/ showed a marked deterioration.

Reaction of banks to the worsening economic conditions in Poland varied. U.S. banks began to restrict the extension of new credit to Poland, allowing their claims to rise only $9 million between December 1976 and December 1978. Other banks, however, particularly those in Western Europe, exhibited considerably less discretion in allowing their claims on Poland to rise during the same period from $5.6 billion to $12.4 billion. This portentous rise was due in part to the adoption by Bank Handlowy of a policy of demanding and obtaining two- or three-year credits from foreign banks for Polish imports of raw materials and spare parts. Formerly, payment for such imports had been settled immediately in cash or by short-term loans (less than a year); Polish importers had until that time been granted medium- or short-term credits only for the import of capital goods. Now foreign exporters of non-capital goods to Poland

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13/ This rapid rise is a result of the shortening of the maturity structure of the debt.

14/ This ratio gives the number of years that would be required for exports to pay off the debt if neither the level of the debt nor the annual value of the exports changed in the meanwhile.

had to arrange medium-term credit with banks in their home countries. Banks were naturally reluctant to deny such credit requirements to long-standing customers.

The financing of non-capital imports not only broke the link between credits and capital investment but also shortened the profile of Poland's debt maturity. In effect, this development forced Poland to rely less on advanced technological industries and more on traditional export industries, such as coal mining (for which the market was softening), just when shorter maturities were adding to the debt-service burden. Unpleasant economic adjustments loomed on the horizon but were apparently ignored by the Polish Government and by the Western banks that continued to extend credit to the shaky Polish economy.

Although U.S. banks were careful during this period not to increase their exposure in Poland, they hesitated to reduce existing exposure for fear that such cuts would worsen longer-term prospects by precipitating a balance-of-payments crisis. Though cautious, they made no attempt to influence Polish economic policy.

C. The Crisis (1979 to the present)

Polish efforts to restrain imports produced a modest reduction in the trade deficit after 1977, but rising interest payments on the debt began to worsen the current account deficits after 1978. Again, although the net debt-to-export ratio was stabilized at about 2.4 (that is, exports kept pace with the increase in overall debt), the size of the Polish external debt nearly doubled from about $14 billion to $26 billion between 1977 and 1981.

By disclosing a planned austerity package and promising full information on its convertible currency position, Bank Handlowy managed in January 1979 to convince a consortium of Western banks (U.S., British, Canadian, and

Japanese) to syndicate a loan of $550 million. But because the information disclosure lacked data on foreign reserves and short-term credit (now a significant element in overall debt), Western bankers appear to have seriously over-estimated the Polish Government's ability to implement the austerity measures needed for economic readjustment, which in any case depended in large measure on the uncertain cooperation of Polish workers in raising production. Nor did the bankers make allowance for the effects of exogenous shocks, such as the severe winter of 1978-1979 and the poor harvest the following summer.

The loan negotiated in January 1979 merely bought time for the Polish Government; an economic timebomb was ticking. The debt-service ratio jumped to 70 percent (that is, $7 out of every $10 earned by exports to the West went straight back to Western banks) by the end of 1979 and short-term loans began to mature at alarming speed. Bank Handlowy, lacking the credibility to approach the syndicated Eurodollar market, nevertheless succeeded in negotiating with the French and German Governments the refinancing of some maturing export credits these Governments held. The French agreed to refinance $300 million, but at full percentage point over the base bank rate; the German Government refused to refinance more than $60 million.

These payments, though small, enabled the Poles to meet their payment schedule into early 1980. In April 1980, relying on the heartening news of a trade surplus in the first quarter of 1980 (attributable to higher earnings on the export of coal, copper, and silver), Bank Handlowy attempted to syndicate a further Eurodollar credit of $500 million. Most of the major international banks involved in the $550 million credit of January 1979 refused to join in the new syndication unless the Polish Government undertook fundamental policy changes and adhered to a set of specific priorities designed to increase its hard currency earnings. Interest in syndication waned as the Polish Government delayed its response to these conditions, for although foreign banks were willing (or forced) to maintain their level of exposure by financing maturing credits, few wished under the circumstances to join in syndicating a fresh loan.

The Gierek government, having brought the nation to the edge of bankruptcy through its ineffective economic policies and unable to secure further credit, determined at last in the summer of 1980 to grasp the nettle and put through the necessary and unpleasant measures demanded by its creditors. Ignoring reform of bureaucratic privilege and elimination of corruption, it fastened its severest measures on the workers, many of whom participated in a general strike in August 1980 under the leadership of the Solidarity Union. Gierek's government eventually fell, leaving foreign governments and banks to adopt a wait-and-see attitude while its successor governments attempted to reorganize the deteriorating economy. By the end of 1980, Poland's industrial output was down 3 percent from the preceding year, agricultural production was off 10 percent, and gross fixed capital investment had fallen 7.5 percent. The debt-service ratio jumped 15 points to 85 percent, the current account showed a deficit of $2.7 billion, and the gross foreign debt reached an estimated $24 billion.

VII. PRESENT PROBLEMS

The debt now (January 1982) stands at about $26 billion, of which about $10 billion is owed to 16 Western governments and the remaining $16 billion to 460 Western banks. The U.S. Government holds $1.8 billion of Poland's $10 billion government-to-government debt. Another $1.3 billion of the debt is divided among 60 U.S. banks. Thus claims on Poland by the U.S. Government and U.S. banks total about $3.1 billion. Although there is a good deal of uncertainty about which banks are most seriously exposed to Poland, Bache, Halsey, Stuart, Shields, Incorporated, recently estimated the following amounts: 15/

Bank of America	$125 to 150 million
Citicorp	75 to 100 "
Chase Manhattan	75 to 100 "
Manufacturers Hanover	75 to 100 "
Morgan Guaranty	75 to 100 "
Chemical Bank	60 to 80 "
First Chicago	50 to 75 "
Continental Illinois	25 to 50 "
Security Pacific	10 to 20 "
First Interstate	5 to 15 "
Wells Fargo	5 to 10 "

15/ Quoted in: Salamon, Julie and Gary Putka, Doubts Concerning Polish Debt Payments. Wall Street Journal, December 18, 1981. p. 2.

The German banks are on the whole much more seriously exposed. The Poles owe about $4.5 billion to 60 German banks. About $1.8 billion of this amount is guaranteed through government export-credit insurance, which makes part of the debt a contingent liability of the German Government. This means that $2.7 billion of bank debt is not covered by government guarantees. The following are the principal German banks holding the debt: 16/

	Guaranteed	Not Guaranteed
Bank fuer Gemeinwirtschaft	$419 million	$344 million
Commerzbank	401 "	264 "
Deutsche Bank	308 "	198 "
Dresdner Bank	300 "	176 "
Hessische Landesbank	198 "	79 "
Westdeutsche Landesbank	185 "	66 "

The remainder of the debt is held by about 340 banks in sixteen nations. All these banks (and their governments) are naturally nervous about the capacity of the Polish economy to service the debt.

They have reason to be nervous. With total foreign exchange earnings running at only about $500 million a month, Poland's creditworthiness has been in serious doubt. When in March 1981 Bank Handlowy informed the Western bankers that it would need more time to repay the $2.4 billion coming due in 1981, the bankers knew they were in trouble. For them there are only two choices: to

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16/ Geddes, John M. German Banks Fearful on Polish Loans. Wall Street Journal, December 24, 1981. p. 11.

demand immediate payment from the Poles (and thereby put the nation inevitably into default) or to arrange for restructuring or rolling over the debt, that is, putting off the repayment of the principal and restricting collection to the payment of interest. 17/ To help in their estimate of the risks involved in a roll-over scheme and the probability of repayment, the banks presented to the Polish authorities in September 1981 a document entitled "Economic Information Requests". The bankers break their information requests into five categories:

1. An English and Polish text of Poland's stabilization program passed last summer by the Sejm, Poland's parliament.
2. Precise information on the extent of the Polish debt, distinguishing between convertible currency accounts and accounts in the currency of the Council for Mutual Economic Assistance nations.
3. Data on manufacturing production and materials allocation, including figures on the production of coal, natural gas, textiles, apparel, leather, paper, wool, and much more.
4. Estimates for the 1981 harvest and projections for livestock and animal products through 1982.
5. Information on the imbalance between money incomes and household expenditures for goods and services, that is, on the size and extent of the Polish black market. 18/

17/ A roll-over extends the term of the loan for a specified period.

18/ International Economic Committee Multinational Task Force. Economic Information Requests. September 11, 1981. The following are members of the International Economic Committee: Carlo Boffito (Italy), Gabriel Eichler (U.S.A.), Azusa Oshima (Japan), Lawrence Brainard (U.S.A.), Cliff Evans (Austria), Reinhold Stoessel (Germany), Ivor Coffin (U.K.), and Yves Laulan (France).

This document is unique in that it represents the toughest demands by Western banks for information on a wide spectrum of economic matters, including data on foreign reserve holdings, which Communist powers have traditionally regarded as state secrets.

In partial response to the creditor banks' demands for information, the Polish authorities prepared a document entitled "Second Draft Report on Poland's Economic and Payments Situation." 19/ This document paints a grim picture of the Polish economy. The report notes that in December 1980 the Polish Government was holding only $1 million in hard currency reserves; it got through the first quarter of 1981 only because of a crash loan from the Soviet bloc of $400 million granted on exceptionally convenient terms. As of September 30, 1981, Polish hard reserves amounted to only $210 million in gold and $18 million in convertible currency, a total of $228 million. Such reserves, representing less than two weeks worth of imports, are astonishingly meager for a nation of 35 million people.

Domestic accounts do not relieve this gloom. The report estimates that the financial accumulation of state enterprises (sales revenues over costs) dropped from 232 billion zlotys in the first half of 1980 to a deficit of 146 billion zlotys in the second half of 1981. 20/ The Polish budget had a surplus of 41 billion zlotys in 1979 and a deficit of 26 billion in 1980. It will have an estimated deficit in excess of 200 billion zlotys in 1981 due to the fall in revenue from state enterprises, which contribute some 70 percent of

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19/ Lipsky, Seth. Polish Report Reveals Economy's Weakness. Wall Street Journal, December 7, 1981. p. 31.

20/ The official exchange rate of the zloty is 34 to the dollar. On the black market a dollar is said to buy about 500 zlotys.

their "profits" to the state. (Strikes attending the military takeover in December 1981 will probably lead to even larger deficits.)

Western creditor governments agreed in April 1981 to reschedule part of the $10 billion debt owed to them. Under terms of the agreement struck with the Polish Government, the creditor governments delayed for four years the repayment of the $2.4 billion due in 1981. The share of this rescheduled debt owed to the U.S. Government is $380 million. 21/

Meanwhile the $16 billion debt to 460 private banks remains. Since it was obvious that Poland lacked the economic resources to pay off the principal, a sixteen-bank steering committee, coordinated by the German Dresdner Bank, attempted to work out with Bank Handlowy a roll-over agreement to make repayment more feasible. The agreement rescheduled the $2.4 billion Poland should have repaid during the last nine months of 1981. According to the agreement, Poland was given a breathing space of four years on the repayment of 95 percent of the principal, which is to be accomplished in twice-yearly installments beginning December 10, 1985, and ending three years later. The remaining 5 percent is to be repaid in three installments within a year. Interest payments on the balance of the debt are to be met regularly at a slightly higher rate than that on the original credit. The Poles were to pay part o. the 5 percent of loan's principal and the interest due in 1981, a total of $500 million, before the agreement went into effect. This amount was due at the time of signing the agreement, originally scheduled for December 28, 1981.

21/ Agricultural credits make up the bulk of official Polish debt held by the U.S. Government. In October 1981, the Poles requested a further $740 million in agricultural credits for 1982. Madision, Christopher. The Polisn Dilemma. National Journal, v. 13, December 12, 1981. p. 2190.

By the eve of the military takeover in Poland (December 13, 1981) about $150 million of this sum had been paid. Soon afterwards the Poles sought to borrow the remaining $350 million from Western banks but their request was met with an understandably chilly reception. A trickle of payments toward the $350 million balance flowed into Western banks 22/ until it was finally announced on January 4, 1982, that the total balance had been received. 23/

There was danger in delaying this payment. One of the 460 banks might have broken ranks, declared Poland in default, and sought a court order to attach Polish assets. Because of "cross-default clauses" in the syndication agreement, all other banks would then have done the same and the whole rescheduling agreement would have come down like a house of a cards. The rescheduling steering committee was anxiously keeping the banks (especially the smaller ones) in check.

It is to everybody's advantage that the Polish loan has been successfully rescheduled. The Poles need as much credit as they can get to rebuild their shattered economy: they cannot afford a default at this point. 24/ The Soviets would derive no benefit from a Polish default. Such a default might well prejudice Western bankers against extending credit to the Soviet Union or induce them to demand a higher risk premium on such credits (for example, on the loan, worth perhaps $15 billion, they are now negotiating with the

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22/ Tagliabue, John. Poles Make Small Debt Payments. New York Times, December 30, 1981. p. D1.

23/ Hudson, Richard L. and Gerald F. Seib. Poland Raises $350 Million in Interest Due in 1981. Wall Street Journal, January 4, 1982, p. 4.

24/ Under present circumstances the Poles are incapable of meeting their debt obligations. They have a pressing need for capital, perhaps as much as $20 or $30 billion, in addition to present borrowings in order to be able to repay these borrowings.

USSR for the Yamal natural gas pipeline). Meanwhile the Soviets must use up their own hard-earned convertible currency in keeping Poland afloat. 25/ Moreover, Comecon's credit needs would be jeopardized by a Polish default: the Eastern bloc owes the West about $70 billion, and it is eager to keep open this line of credit. Finally, Western banks have nothing to gain from a default. Their hard line with the Poles was to a certain extent a bluff as it is obvious that the banks are willing to go to considerable lengths to keep Poland from formal bankruptcy, including putting off for a very long time the repayment of principal, contenting themselves meanwhile with the payment of interest.

Supposing the worst--total default--had happened: What would have been the effect on the U.S. banking system? There is a great disparity in exposure, from the $150 million owed Bank of America to the $300,000 owed the Indiana National Bank of Indianapolis. As far as U.S. banks are concerned, their practice of not assuming an aggregate exposure of more than 10 percent in any one country has prevented the Polish debt from representing a major part of the banks' total loan portfolios. Few U.S. banks have material exposure relative to earnings and capital. Chemical, Manufacturers Hanover, and First Chicago, each have loans to Poland equivalent to 5 percent of their equity. Bank of

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25/ There are rumors that the Soviets have been gathering hard currency on behalf of the Poles. The Financial Times of London reported in mid-December that the Soviets had given Poland ruble credits equivalent to nearly $4 billion, and the Wall Street Journal claimed that the International Investment Bank of Moscow lined up a $100 million, 5-year credit from a group of Western banks, perhaps to be used toward the amount now payable by the Poles. Furthermore, the fall in the price of gold during the latter half of December 1981 might have been due to Soviet sales to acquire hard currency for Poland. Finally, Soviet deposits with Western banks have plunged from $8.6 billion in December 1980 to $3.6 billion in June 1981. Salamon, Julie. Western Bankers Rebuff Polish Attempt to Pay $500 Million Interest with Loan. Wall Street Journal, December 17, 1981. p. 2. The German Banks Sky-High Polish Debts. The Economist, v. 28, December 19, 1981. p. 74.

America is exposed to 4 percent of its equity; other banks considerably less. Given the small exposure of U.S. banks, it appears highly unlikely that Polish default would cause U.S. bank failure. Although dividends for shareholders might fall or be eliminated for a year or two, depositors are in no danger of suffering any losses. 26/

German banks are more exposed than U.S. banks and accordingly would experience more difficulty in adjusting to a default. But even the most exposed bank, Bank fuer Gemeinwirtschaft, owned by German labor unions, is fairly well protected. Although its uncovered debt is $344 million, the bank has group assets and published reserves of $750 million. 27/ The Dresdner has been increasing reserves for potential loan losses. No German bank is, however, likely to collapse because of a Polish default, although major write-offs would shake confidence in the German banking system.

26/ Big drops have been recorded in December 1981 stock market trends of shares in the larger exposed banks. Salamon, Julie and Gary Putka. Doubts Concerning Polish Debt Payments. Wall Street Journal, December 18, 1981. p. 2.

27/ Geddes, John M. German Banks Fearful on Polish Loans. Wall Street Journal, December 24, 1981. p. 11.

VIII. CONCLUSIONS

Now to return to the questions posed at the beginning of this report. What went wrong with lending to Poland? What went wrong is that banks made loans beyond Poland's capacity to repay. They did so for several reasons: because of their need after 1973 to recycle petrodollars, because to lend to Poland at higher interest rates than they could realize domestically seemed at the time good business, and because (for German bankers) considerations of detente and of the special relation between Germany and Poland allowed for less than normal stringency in setting conditions for repayment. German bankers in many instances, presumably encouraged by their government, appeared to act more as diplomats than as bankers. Furthermore, many credits were not tied to specific, analyzable projects. The growing use of medium-term credits dangerously shortened Poland's debt-maturity schedule. Finally, balance-of-payments credits tended to reduce Poland's accountability for its borrowings. These factors conspired, at last, to put Poland in a position where repayment was beyond its exchange-earning capacity.

To what extent are U.S. banks exposed? All things considered, U.S. banks are only moderately exposed in Poland, thanks to a prudent policy of allowing only small incremental exposure in the years after 1976 when signs first appeared that the Polish economy was in difficulty.

In the event of a default, what should be the effect on U.S. banks? No U.S. bank is exposed in Poland for more than 5 percent of its equity, a loss which could be made up in a few years from earnings. There is no realistic danger of failure of a single bank, to say nothing of the whole system.

Questions - Petty
from Senator Garn

MARINE MIDLAND BANK, New York

1. Mr. Rohatyn noted that the Polish debt problem has had the impact of reducing credit to the Soviet Union and its Eastern European allies. Had it also had the impact of limiting credits to Western and/or pro-Western countries?

The Polish debt problem has indeed reduced the credit available to the Comecon countries.

Moreover, the problem has occasioned reviews of various international lending programs, especially in view of comments by bank stock analysts and regulators about the uncertain world environment and the debt burden of LDC's. To the extent these general problems diminish or perhaps even tend to diminish the capital strength of lenders, there may be, marginally, more caution displayed on international lending in general. However, I am aware of no occasion where a lender has argued that because of Poland's problem they should not lend in the West.

2. If Polish commercial and officially backed debt to the United States were declared to be in default, then the Polish Government, according to some analysts, would cease making payments to the U.S. entities, repaying only its obligations to the Europeans. Should such a payment be made, for example, to a West German bank, what would prevent the U.S. creditors from attaching such assets extended by the Polish Government beyond its borders?

The question is, would a German court claim jurisdiction on a U.S.-Poland dispute on an American loan denominated in dollars, especially when a paragraph in the loan agreement probably identifies laws of the State of New York governing disputes under the agreement. This is a most nebulous area and courts have been reluctant to let themselves be interjected into such disputes.

If the funds are viewed as belonging to Poland, then sovereign immunity questions also arise.

If the funds are transferred to a West German bank, particularly if in settlement of a West German bank claim, it is difficult to see how a U.S. creditor would have a legal right to that payment in preference to the stated beneficiary.

3. Can avoidance, for political reasons, of an official declaration of default somehow run afoul of U.S. bank examination and accounting practices?

The offical declaration of default by a lender is an act normally considered against the objective of maximizing the prospect of repayment. I would imagine bank regulators and independent auditors would view either the taking of an act, or its avoidance, for political reasons as most inappropriate conduct for a regulated lender.

4. Was the idea of a Soviet umbrella covering the debts of its allies ever a reasonable assumption?

What was reasonable to assume some years ago when debt was low has a way of appearing less reasonable when debt is high.

The Soviets, I believe, have taken measures to aid Poland economically; for example, in the price they charge for energy. Cash payments have also appeared from Moscow, perhaps nominally for food.

When does support take on all the attributes of an umbrella? Perhaps, only the future will tell, especially as it may not be in the Soviet interest to remove all conjecture on this matter.

Questions - Petty
from Senator Heinz

1. If Poland is formally declared to be in default what implications would this have for the rescheduling of debt for Third World countries?

That probably depends upon Poland's reaction and subsequent events. For example, if Poland repudiates or declares a moratorium on U.S. claims (at least official claims) and non-U.S. lenders work with Poland to reschedule debt, then some Third World countries may feel there is a lesson in that experience.

Basically, an official declaration of default against a sovereign country is not a productive act for lenders. Furthermore, the initiative for subsequent events then shifts to our trading partners and Warsaw.

To all this, some of the Third World (but certainly not all) will watch attentively for opportunities to justify reprieve from their obligations.

2. Mr. Rohatyn argued in his statement that the German banks who hold the greater share of debt could be bailed out, or their adversity could be minimized, by assistance from the German central bank. Would you agree with his solution to the problem for Germany, or for the United States?

Much of the German debt is guaranteed by the Government through Hermes, their version of our Export-Import Bank. Whether or not the government would assist German banks by purchasing non-guaranteed debt is not clear, but the Federal Republic of Germany would not allow major German banks to fail.

Federal Reserve support of defaulted Polish debt on the books of U.S. banks is inappropriate. True, U.S. banks were actively encouraged to lend to Eastern Europe by three Administrations in the 1970s; but this does not imply an obligation by our Central bank to cover for them. Finally, Mr. Rohatyn would make substantial charge offs now (as opposed to adequate reserves now). The judgment of numerous banks and independent auditors would not agree.

3. What level of East-West trade can be conducted without significant access to Western credit?

Eastern bloc exports for hard currency would become the primary determinant of Comecon imports. The dollar value of such exports is influenced by such variables as the price of gold and the economic growth rate of the OECD countries.

Eastern bloc exports the past few years have been

78	$ 23.9 billion
79	$ 32.4 billion
80	$ 38.6 billion
81	$ N/A

4. What should be the U.S. attitude toward Polish membership in the IMF and the World Bank? Is Poland too far gone economically to be a meaningful participant?

Membership should be supported.

The extension of credit is a separate issue and clearly inappropriate now.

Membership in the IMF requires an extensive exchange of information by prospective countries with the Fund staff. An economic program which provides credible means to achieve economic growth must be demonstrated to the IMF.

The process would impose economic discipline on the country which would make it more attentive to the needs of its people, a more reliable trading partner and better able to carry out its international obligations. To achieve its economic objectives Poland would have to improve productivity, come to terms with its labor force, decentralize decision making and open its economy, at least somewhat.

5. What kind of conditionality might the West place on Eastern European membership in the multilateral financial institutions?

The basic IMF membership condition is adequacy of information and adherence to the principals of the charters.

Conditionality on the extension of credits by the multilateral financial institutions should be neither more nor less than that required of other borrowers.

We have the benefit of a very recent Treasury study indicating the adequacy of these standards of the IFIs.

DEPARTMENT OF STATE

Washington, D.C. 20520

JUN 16 1982

Dear Mr. Chairman:

This is in response to Mr. Paul Freedenberg's letter of March 12 requesting information concerning United States policies toward Poland. I am pleased with this opportunity to clarify these issues for the public record.

The following is an official and comprehensive list of sanctions imposed by the United States Government in response to the situation in Poland. Replies to the other questions posed in Mr. Freedenberg's letter are enclosed.

Summary of Measures vis-a-vis Poland

1. Halt in the renewal of Export-Import Bank's line of credit insurance to the Polish Government.

2. Suspension of Polish civil aviation privileges in the United States.

3. Suspension of Poland's fishing privileges in U.S. waters.

4. Tightening in concert with allies of restrictions on high technology exports to Poland.

5. Suspension of U.S. Government consideration of Polish requests for additional credits to purchase U.S. agricultural commodities.

6. Agreed with other Western creditor governments not to negotiate rescheduling of Polish official and guaranteed debt falling due during 1982.

The Honorable
Jake Garn, Chairman,
Committee on Banking, Housing
and Urban Affairs,
United States Senate.

Summary of Measures vis-a-vis the USSR

1. All Aeroflot service was suspended: Aeroflot operated two weekly flights from Moscow to Washington.

2. The Soviet Purchasing Commission was closed as of January 1, 1982. The Soviet Purchasing Commission (formerly "Kama Purchasing Commission") was a commercial organization which had been operating in New York with a staff of ten.

3. Issuance of renewal export of licenses to the USSR of electronic equipment, computers and high-technology materials was suspended.

4. Negotiations on a new long-term grains agreement were postponed. (This does not affect current sales or shipments of grains.)

5. Negotiations on a new U.S.-Soviet Maritime Agreement were suspended and a new regime of port-access controls was put into effect for all Soviet ships when the current agreement expired on December 31, 1981.

6. License requirement was imposed for export to the Soviet Union of an expanded list of oil and gas equipment, including pipelayers. Issuance of such licenses, however, was simultaneously suspended. Under the foreign-policy controls of the Export Administration Act, we already required validated licenses for exports to the USSR of oil and gas equipment and technology in the energy exploration and production areas.

7. U.S.-Soviet exchange agreements coming up for renewal in the near future, including the agreements on energy and on science and technology, will not be renewed. There will be a complete review of all other U.S.-Soviet exchange agreements. There are eleven bilateral science and technology agreements with the Soviet Union.

I trust that the above information and the enclosed answers to your questions and those of Senator Heinz and Senator Proxmire will be responsive to Mr. Freedenberg's letter.

With cordial regards,

Sincerely,

Powell A. Moore

Powell A. Moore
Assistant Secretary for
Congressional Relations

Enclosures:

Replies to questions of Senators Garn, Heinz and Proxmire.

RESPONSES TO SENATOR GARN'S QUESTIONS

1. Q: Would a unilateral declaration of default by the United States Government, or by banks prompted by the U.S. Government, be viewed as an unfriendly act by the German Government?

   A: The Federal Republic of Germany has supported Western sanctions against Poland and the Soviet Union following the imposition of martial law December 13, 1981. The West German government has appealed to the Polish government to demonstrate its credibility by releasing all detainees, by restoring the freedoms obtained through the course of renewal and reform and by resuming dialogue with patriotic forces of the Polish people. Private banking institutions and credit agencies have made it clear that they fully expect Poland to repay its debts with interest. Although we know of no official FRG government statement regarding default, the FRG does not believe the Polish government should be released from its debts by officially calling Poland into default.

2. Q: Have Western bank credits allowed the Soviet Union and its Warsaw Pact allies to devote more resources to military hardware than they would have been able to do in the absence of those credits, due to the inefficiency of their economic system?

   A: The Soviet government has consistently given top priority to defense expenditures, which averaged about 12 to 15 percent of Soviet GNP over the last decade. While it is extremely difficult to speculate on what Soviet defense expenditures might have been in the absence of Western bank credits, it is probable -- based on past Soviet performance -- that defense expenditures would have been sustained and that any Western cutback on credits to the Soviets would have resulted, first, in a cutback in resources allocated to consumer goods. The Soviet population's standard of living (including diet) would not have improved nearly so rapidly as it did in the absence of Western credits. Moreover, the current Soviet liquidity crunch has forced the government to further reduce imports of consumer and investment/capital goods; there is no evidence, however, that defense expenditures have been adversely affected by Soviet financial difficulties.

3. Q: What is the best way to politicize the Polish debt? Must we be unilateral or can we call a conference of the creditor nations to provide united allied pressure? Could such a conference be expanded to deal with credit for the pipeline? Would the Europeans fear that that would be

indeed what would happen?

A: From the outset of the Polish financial crisis, the U.S., its allies, and other major Polish creditors have consulted closely on the Polish debt problem. A committee of representatives from Poland's 16 official creditors was formed in the spring of 1981 in response to the Polish declaration of a debt moratorium and request for debt rescheduling. This creditor committee developed a common approach on Polish debt rescheduling that protected the interests of all government creditors while placing maximum pressure on the Poles to both make debt service payments and to take necessary actions on economic reforms.

Following the GOP Polish military government's declaration of martial law in December, Poland's official creditors met and decided to defer consideration of 1982 debt rescheduling until the regime had: (a) released political detainees; (b) reopened a dialogue with Solidarity and the Church; and (c) lifted martial law. This tough and coordinated Western response has effectively maintained maximum political and economic pressure on the Polish government.

Under current circumstances, unilateral U.S. action is neither necessary nor appropriate and would risk providing the Soviet Union an opportunity to drive a wedge between the U.S. and its allies. Despite ongoing allied consultation, a conference on Poland could be a useful mechanism to discuss East-West trade and financial issues, including the broader implications of Eastern European indebtedness to the West and Western credit policies toward the Soviet Union.

4. Q: It is suggested that Western leverage lies not in default itself, but rather in the threat of default. By calling default, then, are we, in effect, shooting our hostage?

A: Western leverage lies in keeping the pressure on Poland to pay its debts. The threat of default enhances the Polish incentive to pay. In contrast, a declaration of default by Poland's creditors would relieve the pressure on the Polish government to pay what it owes. Moreover, to the extent some official government creditors refrained from declaring default, the Polish government could consider them preferred creditors and choose to service their debt alone. Calling default would serve a purpose only if there were assets that could be attached to offset debt exposure, or if Poland were currently receiving private credits, which would dry up in the wake of default. Since there are few Polish assets abroad that could be attached and since Poland is not receiving private credit, an official declaration of Polish default would achieve little and destroy what leverage Poland's creditors still have.

5. Q: All of the Eastern European countries, including the Soviet Union, are facing major economic difficulties in this decade. Some have suggested that these difficulties would have arisen much sooner had it not been for the extensive Western credits supplied over the past ten years. Demand for hard currency is expected to become particularly acute, especially as the need for imported energy increases. In fact, recent accelerated gold sales by the Soviet Union do not seem to have been used by the Soviets to finance Polish debt payments but rather to provide the Soviet Union with needed hard currency.

Aren't further credits to the Soviet bloc, sending good money after bad, merely postponing and enlarging an eventual default, while at the same time helping them avoid the costs of economic adjustment?

A: It is true that during the coming decade all of the Eastern European countries face somewhat similar economic difficulties stemming from their externally imposed management system and shared economic dependence on the Soviet Union. It is incorrect, however, to infer from this that all of the Eastern European countries share the same number or degree of economic problems or that there are not large differences in living standards, in efficiency of production, growth, resources, and other economic indicators. Hungary, for example, is experiencing no consumer goods shortages, and is a net exporter of agricultural products. It has instituted market-oriented economic reforms which are, in part, responsible for Hungary's relative well-being. Apart from Poland, other Eastern European countries are experiencing reduced economic growth stemming from a number of factors. Inherent defects in their Soviet-style economic management systems are only partially responsible for these problems.

There is little question that some Eastern European countries, particularly Poland, have used freely accessible Western credit to postpone needed adjustment in their domestic economic policies and practices. One result is the present liquidity squeeze affecting all of Eastern Europe (and even the USSR) with varying degrees of severity. Recent cutbacks in Soviet supplies of oil to certain Eastern European countries will add to the demands placed on their scarce convertible currency resources. This effect will be somewhat ameliorated by declines in market prices for oil, however.

Despite current liquidity problems, it is an exaggeration to assert that an eventual default by all of Eastern Europe is inevitable, and that to supply additional Western credits would be, therefore, to send good money after bad. Additional credits would not help the Soviets to avoid the costs of economic adjustment; they would simply postpone the day of reckoning of those costs.

Further, certain of the Eastern European countries which are either relatively well managed or which have followed conservative financial policies are likely to face relatively little difficulty adjusting to a cut-off of Western official and guaranteed credits. This is also true of the Soviet Union itself.

With respect to the question of whether Western lending contributed resources toward the building of the Warsaw Pact's military might, it might be pointed out that Eastern Europe as a whole ran larger trade deficits with the USSR during the past decade than the total of net Western lending. Eastern Europe as a whole ran trade deficits with the USSR averaging $6 billion annually during most of the 1970's, an estimated $10 billion in 1980, and roughly $22 billion in 1981. This large transfer of resources primarily took the form of implicit trade subsidies, as the Soviet Union continued to supply its Warsaw Pact partners petroleum and other raw materials on below-market terms. The Soviet motivation for doing this was undoubtedly to buffer the economies of Eastern Europe, against world prices, but also to maintain political stability and economic dependence on the Soviet Union as a means of preserving Soviet control over the region. Moreover, since Eastern Europe sought Western technology that the Soviets were unable to provide, it is unlikely that Western credits substituted for Soviet financial support and thus lightened the Soviet burden. The absence of Western credits probably would have meant a lower standard of living for Eastern Europe rather than a reduction of Soviet assistance.

6. Q: What opportunities does the Polish debt question give the United States to prevent, or slow down significantly, the construction of the Soviet natural gas pipeline? Would a formal declaration of default of the Polish debt prevent Western financing of the pipeline?

A: The Polish debt situation does not give us more leverage against the pipeline. A unilateral U.S. declaration of default against Poland would not have a significant impact on the construction of the Siberian gas pipeline.

The pipeline financing has already been put in place and deliveries of pipe and equipment are in progress. Moreover, while Poland is clearly bankrupt and viewed as a very poor credit risk by Western banks and governments alike, the Soviet Union, which commands vast natural resources, including substantial gold reserves, is still viewed by West Europeans in particular as a good credit risk and a valuable trading partner.

7. Q: What are the prospects for coordinated allied managing of the Polish debt, with unified pressures and conditionality on the Polish Government?

A: Poland's Western creditors continue strongly to support the decision adopted in early January to defer any consideration of a 1982 debt rescheduling until the GOP lifted martial law, freed political detainees, and established a new dialogue with Solidarity and the Church. Based on allied performance over the past year since Poland declared a moratorium, we remain hopeful that close allied coordination on the Polish debt issue will continue.

RESPONSES TO SENATOR HEINZ QUESTIONS

1. Q. Do you think the suggestion made in the hearing by Felix Rohatyn to pay 50 cents on the dollar and have the Western central banks buy up the Polish debt, is sensible or feasible?

A: Mr. Rohatyn's proposal for central banks to acquire Polish debt at a discount from commercial banks and then declare the country in default is not feasible. It would be viewed in this country, and undoubtedly in some Western European countries as well, as a direct bail-out of the private banks (even at 50 cents to the dollar) at the taxpayers' expense. Moreover, his proposal assumes a willingness of West Europeans to support this strategy which would likely not materialize. It is a variant on the straight default option, and has the same drawbacks. It appears not to discriminate among the Eastern European countries -- some of which are closer to us economically and politically than others -- either in terms of their economic or political situation -- and draws premature conclusions about Western and Soviet interests in trading Western financing against Soviet concessions in other areas. A more detailed discussion of these issues follows.

Western European governments would not likely join in a coordinated declaration of default against Poland. The NATO allies are in agreement that we should not call Poland in default at the present time, but should press for collection of existing debts and suspend negotiations on the rescheduling of Poland's 1982 debt pending a favorable evolution of the Polish political situation. However, if faced in the future with a stark choice between rescheduling and default, we believe that the Western Europeans would almost certainly opt for rescheduling, and would probably not link this decision to Soviet behavior in Eastern Europe.

From the U.S. standpoint the proposal is essentially a variant on the straight default option and has the same drawbacks. In our view, the best way to keep sustained pressure on Poland, and indirectly on the USSR, is to lean hard on the government of Poland to pay its debt. Further, we will continue to make decisions on the extension of official credits/guarantees to the Eastern European countries on a case-by-case basis, in light of the credit worthiness of the country concerned and in a fashion consistent with the present U.S. policy of differentiation.

Mr. Rohatyn's proposal ignores the substantial political, cultural, and economic differences among the Eastern European countries.

U.S. policy has for years deemed it appropriate to differentiate among those countries both in terms of their economical/political circumstances.

2. Q: Hungary seems to be drawing closer to the West and going increasingly to a market oriented economy. Do you think that relationship would be adversely affected by default, either unilateral or coordinated?

   A: Hungary has gone farther in implementing market oriented economic reforms than any other CEMA country. The result is a living standard that is the envy of its neighbors along with a growing dependence on trade with the West. Hungary's increasing reliance on Western markets and market mechanisms is underscored by its membership in the IMF. But Hungary, like any industrialized trading nation, is dependent on continued access to normal banking and financial services. Of course, such relationships are properly based on mutual benefit and the commercial judgments of individual private banks.

   Hungary's access to Western financial markets already has been affected by banks' increased caution following the Polish crisis. Polish default, either unilateral or coordinated, would likely cause a cessation of commercial lending of some duration forcing Hungary to make difficult policy choices; i.e., between continued reliance on Western markets or turning to the Soviet Union and CEMA. Economic reformers in Hungary could be blamed for resulting austerity because they played the game by western rules and lost. In sum, a Polish default would be a serious economic and political blow to Hungary.

3. Q: Felix Rohatyn seems to believe that default would be isolated and concentrated in its effect to Eastern Europe. Do you agree? What do you think the effect would be?

   A: The scenario described by Rohatyn whereby Western governments would declare Poland in default and cut off all credits to Eastern Europe could well lead to an Eastern European bloc-wide default unless the Soviet Union agreed to the preconditions imposed by the West for new lending--an unlikely proposition judging from past Soviet resistance to economic/financial sanctions of any kind. While a Polish default alone would probably be manageable by the international banking system due to the numerous cushions built into the system, a bloc-wide default or repudiation of debt would require direct central bank assistance to some banks and could have broad, adverse (albeit unpredictable) effects on cooperation of the international banking system.

This in turn could affect the ability and inclination of commercial banks to lend to other high risk countries, particularly in the third world. In short, the Rohatyn proposal would embark the U.S. and its allies on an unchartered course of action whose repercussions might not be isolated nor confined to Eastern Europe.

4. Q: The credit needs of the Warsaw Pact nations seem to be quite significant over the next few years, on the order of $25 to $40 billion. During that same time, in the wake of the Polish and Romanian debt reschedulings, the credit ratings of the Soviet Union and Eastern Europe should be fairly poor. Is there any way which you foresee that the U.S. and its allies could require progress toward arms reduction in the Warsaw Pact as a precondition for the extension of new credits?

A: This administration is serious in its efforts to achieve genuine progress in arms control. At the same time, we are also very concerned about the East European debt situation. Thus, we do not foresee drawing a connection of this sort between arms control and the extension of new credits, because to do so would mean trading down on one goal to achieve the other. We believe the Soviet Union and its allies should have as much interest in arms control as we do, so that progress in that area should be possible on its own merits. Moreover, the bulk of the new credits would have to come from the private sector and thus would not be an element in a strategic bargain.

5. Q: Under what sorts of conditions would our European allies be willing to join with the United States in calling default on the Polish debt? What leverage do we possibly have over our allies to get them to join us in a call for default? What leverage do they have over us?

A: The U.S. and its European allies have agreed that we can best keep up sustained pressure on the Polish--and indirectly on the Soviet Government--by insisting that it pay its debts in a timely manner and by keeping the default option open for use at any time that circumstances warrant. It would probably require an extraordinary act on the part of the GOP and the Soviet Union, e.g., a Soviet invasion, to induce our European allies to join the U.S. in calling a default on Polish debt. However, as long as there is some hope of repayment, the West Europeans would probably resist a declaration of default.

Our leverage on our West European allies is probably limited on the default issue, and there is no assurance that other creditors, including both the governments and private banks, would follow suit after a unilateral U.S. declaration of default. Such a decision would be even more unlikely given the fact the Poles have few attachable assets in the West.

The West Europeans could point out that a unilateral U.S. declaration of default would in effect set them up as preferred Polish creditors since the Poles might repudiate their debt to the U.S. and increase the European chances of repayment. Moreover, by indicating their unwillingness to follow the U.S. lead, the West Europeans would have served notice that a split in the Alliance had resulted from unilateral U.S. action.

6. Q: What should be the U.S. attitude toward Polish membership in the IMF and the World Bank? Would such membership help bring about meaningful political reform?

A: The United States determines its position regarding membership applications to these institutions on a case-by-case basis. It has been the United States' policy to support membership in the IMF/IBRD by countries prepared to meet all of the obligations of membership in these institutions. This is consistent with their charters.

The imposition of martial law in Poland has undoubtedly complicated negotiations on its membership in these institutions. The United States and other IMF members will need to consider carefully the results of the negotiations and developments in Poland before reaching a decision on the issue. In making our determination we will, of course, have to reach a conclusion as to the willingness and ability of Poland to fulfill the responsibilities and obligations of the IMF membership.

IMF membership could help bring about essential economic reforms such as decentralization of economic decision-making and a greater market orientation, and thereby influence political reform as well. It is doubtful, however, that IMF membership would have a direct or significant impact on political reforms.

7. Q: What kind of conditionality might the West place on Eastern European membership in the multilateral financial institutions? What value is there to the argument that Polish membership in the IMF would give the West an indirect influence over Polish socio-economic affairs in a manner palatable to the Soviet Union?

A: In order to avoid politicizing the multilateral financial institutions, it is doubtful that the West would wish to place special conditionality on Eastern European membership beyond the normal requirement that countries be prepared to meet all the obligations of membership, including full disclosure of financial data.

We believe that the argument that Polish IMF membership would give the West some indirect influence over Polish socio-economic affairs has some merit. Through the normal IMF consultative process, the U.S. and other Western Executive Directors on the IMF Executive Board would gain a mechanism for commenting on and influencing Polish economic policy. This could be more palatable to the USSR than would a more direct approach. However, Soviet reactions would probably be based on the content of economic reforms rather than the mechanism by which the West brought its influence to bear.

RESPONSES TO SENATOR PROXMIRE'S QUESTIONS

1. Q: The Wall Street Journal recently said in an editorial: "In short, the economies of Eastern Europe are organized to support the economy of the Soviet Union, and the economy of the Soviet Union is organized to support its military machine. Into this process the Western banks have pumped some $60 billion in the decade..."

(a) Do you agree with this organizational characterization of Eastern Europe and the Soviet Union?

A: Such a characterization assumes that there has been a one-way flow of resources from the West through Eastern Europe to the Soviet Union. In fact, Eastern Europe ran a cumulative trade deficit with the USSR of $60 billion during the 1970's. This represents a flow of resources from the USSR to Eastern Europe. Moreover, an estimated 12-14 percent of Soviet GNP annually goes to defense. The Soviet GNP is estimated to have totaled some $1,520 billion in 1980. Defense spending has been growing some 4-5 percent per year in real terms while Soviet GNP has been growing at only about half that rate in recent years. Therefore, satisfying the Soviet military's requirements is unquestionably given very high priority in that nation's economy, the structure of CEMA notwithstanding.

(b) To what extent do Western credits bolster the Soviet economy, enabling them to strengthen their military capability?

A: Western credits are used primarily to finance those Soviet hard currency imports that are important to high priority Soviet goals for food production, energy development, and raising the level of technology and productivity of Soviet industry.

Economic growth in the 1980's projected at 2% per year or less (assuming continuation of recent growth rates), will probably be insufficient to support past rates of increase in defense spending and also to maintain a perceptible rise in living standards. If defense outlays continue to rise at about 4% per year, they would preempt about two-thirds of annual increments to the gross national product in 1990, as compared to one-fourth now, making leadership choices far more difficult. In particular, allocations to consumer industry, agriculture, and transportation would inevitably suffer. If the Soviet hard currency position were further harmed by a loss of Western credits, the leadership would be likely to adopt domestic economic policies restricting private consumption in order to allow for continued growth in defense spending. While Western credits may not directly strengthen the Soviet military, they do make economic decision making easier for the Soviet leaders.

2. Q: You said on page three of your statement that "we and the other NATO countries have additional measures under active consideration if the situation does not improve." What are these measures?

   A: The January 11 NATO Declaration refers to measures in a number of different areas. We have discussed with our Allies measures in all these areas, but our consultations to date have been more in the nature of exploring possibilities, with decisions to be made depending on the situation in Poland, and on the individual circumstances of the countries involved. In any case, any additional measures would probably fall within the framework of the January 11 Declaration. Let me add that we think it equally important that, should the situation in Poland improve, we are ready to consider revoking measures already in effect and to assist Poland in recovering from its economic disaster.

3. Q: The Helsinki Final Act, signed by the Soviet Union and Poland, provides for each signatory to respect the territorial integrity, freedom, and political independence of other states, and to respect the human rights of its citizens.

   (a) Do you believe the Soviet Union violated the Helsinki Accords in its actions in Poland?

   A: The United States considers Hungary's compliance with the provisions of the Helsinki Final Act to be generally satisfactory. A full discussion of our views on Hungary's performance is found in the "Eleventh Semiannual Report by the President to the Commission on Security and Cooperation in Europe on the Implementation of the Helsinki Final Act."

   The Helsinki Final Act encompasses a series of profound political commitments that the signatories were required to undertake; Soviet policy toward Poland has been in blatant disregard of those commitments.

   Beginning with the first strikes and the birth of Solidarity in August 1980, the Soviet Union exerted tremendous political, military, and economic pressure on the Polish leadership to suppress the free trade union movement. The Soviets were directly involved in the decision to impose martial law, and in its implementation. These actions are incompatible with the following principles of the Helsinki Final Act:

-- Principle I: Respect for the sovereign equality of states, including the right of each state "freely to choose and develop its political, social, economic and cultural systems."

-- Principle II: Refraining from the threat or use of force against another participating state, and from "any manifestation of force for the purpose of inducing another participating state to renounce the full exercise of its sovereign rights."

-- Principle IV: Refraining from any action against the territorial integrity, political independence, or unity of another participating state.

-- Principle VI: Non-intervention in the internal affairs of another participating state, including refraining from any form of armed intervention or threat of such intervention, and from "any other act of military, or of political, economic or other coercion."

-- Principle VIII: Respect for the equal rights of peoples and their right to self-determination, including "the right, in full freedom, to determine. when and as they wish, their internal and external political status, without external interference, and to pursue as they wish their political, economic, social and cultural development."

(b) What about Poland?

A: I don't think there is any doubt in anyone's mind that the Jaruzelski government violated the Helsinki Accords by its declaration of martial law on December 13. Its diplomats have admitted as much. The United States has repeatedly condemned Warsaw's violation of the Helsinki Accords and we will continue to expose the Polish government's violation of its population's internationally recognized human rights until such time as Warsaw decides to end martial law, release political prisoners, and begin a dialogue with the Church and Solidarity.

The United States considers Hungary's compliance with the provisions of the Helsinki Final Act to be generally satisfactory. A full discussion of our views on Hungary's performance is found in the "Eleventh Semiannual Report by the President of the Commission on Security and Cooperation in Europe on the Implementation of the Helsinki Final Act."

The Helsinki Final Act encompasses a series of broad political commitments undertaken by each of the signatories. It would be wrong and misleading to attempt to characterize any country's adherence to these commitments in a short statement, since the Final Act encompasses some aspect in almost every sphere of a nation's political and foreign relationship. The United States reviews each Helsinki signatory's compliance with the commitments under the Final Act each year, and issues a report. Consequently, for a full discussion of U.S. views on the performance of East Germany, Czechoslovakia, and Romania, please refer to the attached "Eleventh Semiannual Report by the President to the Commission on Security and Cooperation in Europe on the implementation of the Helsinki Final Act..."

4. Q: According to our information, Western credits have been used by the Eastern European economies to purchase equipment and machinery for pipelines, oil field exploration, chemical manufacturing, textile manufacturing, steel mills, and aluminum smelters. It would appear that Western credits are being used to build strong and modern Eastern European economies. Is it our intent to export Western capital to Eastern European communist countries that do not adhere to the principles of the Helsinki Final Act?

A: Without question, Western credits have been used by the countries of Eastern Europe for all of the purposes mentioned with the intent of strengthening and modernizing the economies of the countries concerned. We note, however, that the end result often has not met these expectations, with Poland an excellent case in point. In fact, these Western credits and the associated capital goods exports have left the Eastern European regimes with varying degrees of dependence on the West for key industrial and agricultural imports and no convenient way to blame Western economic discrimination for their poor economic performance.

In general, adherence to the principle of the Helsinki Final Act is not a criteria which is applied in evaluating whether or not to lend to any particular country. Further, it is firm U.S. Government policy not to interfere in the commercial decisions of private banks or enterprises. Within these criteria, we would observe that it is not our intent to encourage those who would not live up to their commitments under the Helsinki Final Act, and in fact our policies have always been designed to encourage compliance with these principles.

The only Eastern European countries to be granted appreciable amounts of official credits by the U.S. are

Poland and Romania. In each case, there was greater compliance with the principles outlined in the Helsinki Final Act as partial justification for our more favorable stance toward these countries. These do not serve as the sole criteria for lending decisions, however.

5. Q: Mr. Rohatyn testified that: "I hold, as you know, firmly the view that Poland should be declared bankrupt; that the rescheduling of Poland's debts, as well as those of other Eastern European countries such as Romania, be suspended; that new credits to Eastern Europe should not be made available by the Western banking system at this time; that the financial and economic burden of the satellite states be placed squarely upon the Soviet Union; and that future credits to Eastern Europe become linked to the total range of issues presently under negotiation with the Soviet Union, possibly even with arms limitations." What are your comments on Mr. Rohatyn's position?

A: Mr. Rohatyn's proposal for central banks to acquire Polish debt at a discount from commercial banks and then declare the country in default is not feasible. It would be viewed in this country, and undoubtedly in some Western European countries as well, as a direct bail-out of the private banks (even at 50 cents to the dollar) at the taxpayers' expense. Moreover, his proposal assumes a willingness of West Europeans to support this strategy which would likely not materialize. It is a variant on the straight default option, and has the same drawbacks. It appears not to discriminate among the Eastern European countries--some of which are closer to us economically and politically than others--either in terms of their economic or political situation--and draws premature conclusions about Western and Soviet interests in trading Western financing against Soviet concessions in other areas. A more detailed discussion of these issues follows.

Western European governments would not likely join in a coordinated declaration of default against Poland. The NATO allies are in agreement that we should not call Poland in default at the present time, but should press for collection of existing debts and suspend negotiations on the rescheduling of Poland's 1982 debt pending a favorable evolution of the Polish political situation. However, if faced in the future with a stark choice between rescheduling and default, we believe that the Western Europeans would almost certainly opt for rescheduling, and would probably not link this decision to Soviet behavior in Eastern Europe.

From the U.S. standpoint the proposal is essentially a variant on the straight default option and has the same drawbacks. In our view, the best way to keep sustained pressure on Poland, and indirectly on the USSR, is to lean hard on the government of Poland to pay its debt. Further, we will continue to make decisions on the extension of official credits/guarantees to the Eastern European countries on a case-by-case basis, in light of the creditworthiness of the country concerned and in a fashion consistent with the present U.S. policy of differentiation.

Mr. Rohatyn's proposal ignores the substantial political, cultural, and economic differences among the Eastern European countries.

U.S. policy has for years deemed it appropriate to differentiate among those countries in terms of their individual economic and political circumstances.

The Polish situation demonstrates unequivocally that the so called "umbrella theory" to the effect that the Soviet Union is the ultimate guarantor of Eastern European debts is false. There is not a shred of evidence that the Soviet Union is either willing or able to assume the economic and financial burden of supporting the ailing economies of Eastern Europe. Therefore, there would be little added burden on the Soviets if the West undertook to cut off all credits to Eastern Europe. Further, the Soviets rely on economic relations with the West for a relatively small share of their total economic output. They would clearly be prepared, as they have demonstrated in the past, to bear the cost of economic isolation from the West if what they perceived as their vital strategic interest were at stake. Therefore, we judge that there is little ground for inviting confrontation with the Soviets on this issue when it is likely to produce little added leverage for our position. Further, such a U.S. policy would ensure that the countries of Eastern Europe were more fully dependent on the Soviet Union, thereby undermining the long term U.S. goal of encouraging greater independence on the part of these countries.

THE UNDER SECRETARY OF THE TREASURY
FOR MONETARY AFFAIRS
WASHINGTON, D.C. 20220

JUN 21 1982

Dear Mr. Dicks:

This is in reply to Mr. Freedenburg's letter of March 12, 1982, which transmitted questions for the record submitted by Senators Garn and Heinz in conjunction with my February 23, 1982, testimony before the Senate Committee on Banking, Housing and Urban Affairs. The questions they raised and our responses to them are enclosed.

In addition you requested data on Poland's 1981 external debt service obligations. Prior to the rescheduling, Poland's 1981 external hard currency debt service obligations totaled about $9.7 billion including $6.4 billion of principal and $3.3 billion of interest. This includes some $423 million of principal and interest which is owed to the U.S. Government.

The official creditors rescheduled 90 percent of the principal and interest due them during the last nine months of 1981, $2.3 billion out of a total of about $2.6 billion. The U.S. Government share of the official rescheduling was $380 million (90% of $423 million). Western banks rescheduled 95 percent of principal due them during the same time period, -- about $2.3 billion out of $2.5 billion. The banks then deferred repayment of the 5 percent of principal that was not rescheduled ($160 million) until 1982.

The Poles have now paid western banks all the interest due on the unguaranteed commercial debt during the 1981 rescheduling period -- about $700 million. They have paid western governments the 10 percent of principal and interest on debts to official creditors that was not rescheduled except for $26 million still owed to the U.S., $25 million to France and $60 million to Italy.

You also requested a breakdown on CCC loans to Poland between guaranteed loans and direct credits. As of December 31, 1981, CCC's direct credit exposure to Poland totaled $540 million and its guarantees totaled $840 million.

Sincerely,

Beryl W. Sprinkel

Beryl W. Sprinkel

Mr. Ed Dicks
Editor
Committee on Banking,
  Housing and Urban Affairs
5300 Dirksen Office Building
Washington, D.C. 20510

Enclosures

SPRINKEL - QUESTIONS
From Senator Heinz

H-1

Question: Why do you think the Western banks were so eager to lend money to Poland, particularly in the past two years when it should have been clear that Poland was losing its capacity to repay those loans?

Answer: U.S. banks, at least, have not been eager to lend to Poland. As indicated in the table below, outstanding unguaranteed claims of U.S. banks dropped continuously from year end 1979 through year end 1981. At the end of 1981 U.S. unguaranteed claims and commitments were nearly 25 percent below the previous year. Comparable data for non-U.S. banks are not compiled. We believe, however, that unguaranteed claims of non-U.S. banks have not risen much if at all during the past two years.

Unguaranteed Exposure (Claims and Commitments)
of U.S. Banks in Poland 1977-1981
(in $ millions)

	1977	1978	1979	1980	1981
Claims	1242	1216	1413	1461	1197
Commitments	443	438	251	187	46
Total	1685	1654	1664	1648	1243
Change	-	-31	10	-16	-405

Source: U.S. Bank Regulatory Agencies

Question: If Poland and Romania were to go into default, how would that affect further loans to Hungary and Yugoslavia? How about loans to the Third World, would they be adversely affected by Eastern European failures? Would this have an adverse effect on U.S. foreign policy interests?

Answer: We are already seeing the effect of Poland's and Romania's payments difficulties on the attitude of banks toward new lending to other Eastern European countries and Yugoslavia. Little if any new credit is being extended except short-term trade credits, and it is likely that at most such new credit barely serves to offset repayments of earlier lending. A further worsening of the picture for Poland's and Romania's debt would probably make it even more difficult for other countries in the region to raise new credits.

In the event of widespread inability or unwillingness on the part of Eastern European countries to service their debt to banks, these banks would undoubtedly revise their lending strategy. In fact, a reassessment of lending -- including lending to Yugoslavia -- has probably been underway for some time, and some changes in strategy are either already in place, as previously indicated, or in train, irrespective of any further deterioration in the creditworthiness of these countries. The banks could be expected to give preference to the sounder risks, and the terms of lending to some Third World countries would consequently tighten. In this situation, banks would most likely not be providing as high a proportion as in recent years of the external finance sought by developing countries. These countries would thus tend to seek some combination of more funds from official sources or implement adjustment policies to accommodate a lower level of external finance. While such an environment might initially complicate foreign policy, in the long run it would help improve international economic stability, and thereby lay the basis for greater long-term growth.

H-3

Question: The Administration has argued that all the capital is flowing East to West, rather than the reverse, because of the poor credit rating of Poland and the threat of default. What indeed are the capital flows, and has credit for the pipeline been included in these figures?

Answer: The observation of capital flowing East to West, rather than the reverse, refers to the new loans beginning at about the last quarter of 1981; it is based on a careful review of new syndications and market reports rather than on a comprehensive set of capital flow data which are only available with a considerable time lag. For example, we know that Poland has not obtained a syndicated loan from western bankers since September 1981 when it raised DM 1.2 billion from West German banks. Poland did obtain loans and guarantees from Western governments in 1981 prior to its declaration of martial law in December. Since then we are not aware of any private or official funds going to Poland, other than possible rollovers of short-term credits. During the last quarter of 1981 and in the first months of 1982, the Government of Poland paid-up its 1981 interest arrearages to Western banks -- estimated at $300-400 million, has paid the $27 million signature fee to banks for the private rescheduling agreement, and paid most, but not all of the non-rescheduled 1981 official debt. Thus, it is clear that funds are flowing from Poland to the West, rather than vice-versa.

A similar judgment can be made with respect to other Eastern European countries and the Soviet Union -- i.e. no new syndicated loans being made, market reports that other types of loans were diminishing, and those which were made largely with a government guarantee. At the same time repayments were continuing to Western banks. The foregoing judgment takes into account credits extended to the Soviet Union for the Siberian pipeline.

H-4

Question: How much new money is flowing to the Soviet Union and Eastern Europe? How do the last six months compare with the previous six months in terms of new credits to Eastern Europe?

Answer: The latest data which are available on claims of BIS area banks on the USSR, and other Eastern European countries, show a decrease of $1 billion between the first and second half of 1981. These data include adjustments for distortions caused by exchange rate changes. The data include both government guaranteed and unguaranteed bank claims.

H-5

Question: Should U.S. commercial banks significantly reduce their role in petrodollar recycling, would the IMF be able to take over a significant part of the recycling role?

Answer: The U.S. commercial banks, in conjunction with commercial banks in other countries, have demonstrated over the past decade that they have the capacity to intermediate substantial flows of funds from surplus to deficit countries. We would anticipate that they will be able to continue to perform this function.

The experience of the 1970's and recent developments in international lending suggest that banks will be increasingly cautious in their international lending activities. We consider such prudence healthy and believe that it is consistent with the need for many countries to implement appropriate adjustment policies.

In countries where problems do arise, the IMF has played and will continue to play an important role in promoting balance of payments adjustment. We currently are reviewing the adequacy of the IMF's resources to meet the needs of the system and its individual members in the context of the current quota review. However, the IMF cannot be seen as a means to fill financing "gaps." Its focus is on economic adjustment and its funds are used to promote such adjustment.

H-6

Question: Would the formal declaration of default make any significant long-term difference to the Soviets with respect to their economic responsibilities towards Poland?

Answer: The Soviets do not acknowledge any responsibility for the Polish economic and financial debacle. However, they are providing some economic assistance to Poland at present which is a drain on their economy. As a formal declaration of default would largely be a symbolic gesture as far as current and possibly future Polish borrowing in the West is concerned -- the Poles are unable to borrow from private lenders at present and are unlikely to be able to do so in the foreseeable future -- this step will have little significant impact on the Soviet attitudes regarding their economic responsibilities towards Poland.

H-7

Question: Not all of Poland's debts are currently overdue. What effect would declaring default on the overdue portions of Poland's loan portfolio have on the remaining portions of the debt?

Answer: There would be no legal effect on the remaining portions of Polish debt if the overdue portion were declared in default. The remaining portion would be payable according to the payments schedule.

H-8

Question: What is your assessment of the ability of the Polish economy to get back on its feet and be able to meet its international obligations? How long would it take the Polish economy to rebound without Western credits?

Answer: In the short run, it is highly doubtful that Poland will be able to restore its economy to the point where it would be able to meet its international obligations without external assistance. Over the longer run, the likelihood would appear to be much greater. Poland has such basic resources as an educated and technically skilled population, coal, copper, sulphur and other raw materials to earn the foreign exchange needed to pay for western imports and to service its debts.

Hard currency credits can help reduce the time needed to resurrect the Polish economy as well as to mitigate the pain involved in the process. But they cannot, by themselves, do the job. The critical factors involved in this process include the development and implementation of a program of economic reform and the acceptance by the Polish population of the austerity measures and reduced living standards it will require. The greater the willingness and tolerance on the part of the Poles to bear the inevitable economic costs, the quicker the Polish economy can be restored with, or without, hard currency credits. Because of the critical intangibles involved it is impossible to provide any meaningful estimates about how long the process would take.

H-9

Question: Brazil has a significant debt exposure in Poland. How will default on its loans to Poland affect its own financial condition? Will that significantly impair Brazil's ability to meet its own debt obligations?

Answer: Brazil's debt exposure in Poland ($1.5 billion) is small relative to the size of Brazilian exports (6% in 1981). Poland has not, to our knowledge, defaulted on its debts to Brazil. Rather a renegotiation of that debt is taking place. Even if renegotiation results in deferral of $300 million annually in debt service for the next several years (less than 2% of Brazil's own debt service in 1981), Brazil will have little trouble coping with the shortfall. In sum, there is no reason to believe that Poland's debt service problems could in any way seriously impair Brazil's ability to meet its own debt obligations.

H-10

Question: How precisely is default declared? Is it done by an official letter signed by the Secretary of the Treasury, or by a diplomatic note, or just a brief statement from an affected agency? What are the specific mechanics?

Answer: This would be determined by the language of each individual loan agreement. In the case of a purely private loan, the lender would make this determination and communicate it to the borrower by means of a notice sent to the address of the borrower specified in the loan agreement. In the case of a direct loan from a U.S. Government agency, the agency concerned would make the declaration and communicate it according to the notice provision of the particular loan agreement. In the case of U.S.G.-guaranteed loans, the private lender would normally make this determination, except with respect to overdue payments for which it was paid under the guarantee agreement, in which case the guaranteeing agency would be entitled to make the determination.

H-11

Question: What level of East-West trade can be conducted without access to western credit?

Answer: In the absence of credits, a country's ability to import is limited by the amount of foreign exchange it can earn, primarily through exporting, as well as by outstanding debt obligations. In 1980, Eastern European exports to non-communist developed countries earned them $22 billion in foreign exchange. This figure, however, overstates the amount of foreign exchange available for Eastern European purchases of western goods as part of these funds would have to be used to meet outstanding debt service obligations which totaled $15 billion in 1980. If Polish exports and debt service to the West are excluded -- some $7 billion and $10 billion, respectively -- the remaining Eastern European countries would have had an aggregate of about $10 billion to pay for western imports without credits.

H-12

Question: Under what sorts of conditions would our European allies be willing to join with the United States in calling default on the Polish debt? What leverage do we possibly have over our allies to get them to join us in a call for default? What leverage do they have over us?

Answer: The Europeans would be very reluctant to take this step. Since March 1981, for example, they individually could have formally declared Poland in default because of debt service arrearages or, with the imposition of martial law, because of a breach of the exceptional circumstances clause in the multilateral rescheduling agreement. Yet none chose to take this step. It is difficult to envision what conditions, apart perhaps from a Soviet invasion, would result in the European countries being willing to try to declare formally Poland in default. The Europeans, like the U.S., do not perceive it to be in their interest to declare default since maximum pressure is now being applied to Poland under current circumstances, and money is flowing from Poland to the West. The United States could force this issue by unilaterally declaring default. Even then it is not entirely certain that the other governments would follow our lead in this matter, particularly if they viewed our action as a unilateral political act.

H-13

Question: What should be the U.S. attitude toward Polish membership in the IMF and the World Bank? Would such membership help to bring about meaningful political reform?

Answer: The U.S. Government has not taken a decision regarding Polish membership in the IMF and the World Bank. Since it will take the IMF considerable time to complete the necessary technical work -- IMF membership must precede membership in the World Bank -- we anticipate that Poland's membership application will not be ready to be considered by the Executive Board for some time.

The United States determines its position regarding membership applications to the IMF on a case-by-case basis. The imposition of martial law in Poland has undoubtedly complicated negotiations on its membership in this institution. The United States and other IMF members will need to consider carefully the results of the negotiations and developments in Poland before reaching a decision on the issue. In making our determination we will have to reach a conclusion as to Poland's willingness and ability to fulfill the responsibilities and obligations of IMF membership.

H-14

Question: What kind of conditionality might the West place on Eastern European membership in the multilateral financial institutions? What value is there to the argument that Polish membership in the IMF would give the West an indirect influence over Polish socio-economic affairs in a manner palatable to the Soviet Union?

Answer: It would be premature to speculate on the specifics of IMF conditionality with regard to Polish membership. The basic IMF approach to economic issues, however, is supportive of Western economic philosophies and practices. Consequently, membership could encourage adoption of economic policies compatible with the open, market-oriented systems of the Western industrial nations. However, there are other factors which must also be taken into consideration.

SPRINKEL - QUESTIONS
From Senator Garn

G-1

Question: Is default reversible, or even stopable, once the process has begun?

Answer: A lender which has declared a borrower to be in default can at any subsequent time declare that the borrower is no longer in default. However, as a practical matter, a declaration of default is likely to set in motion a chain of events which it is difficult to reverse or stop.

When a lender declares default, it normally accelerates all remaining maturitites of the debt, collects penalty interest, and brings legal proceedings to seize assets of the borrower. These assets would then be sold to meet the outstanding obligation. If, while in the course of taking these steps, the lender decided that the borrower should no longer be held in default, the lender would have to decide whether to reinstitute the original payment schedule in effect prior to the acceleration of maturity, and whether to refund to the borrower any accelerated payments made on proceeds already realized from the sale of collateral or other assets.

The issue is further complicated by the existence of cross-default clauses in credit agreements. Even if one creditor decided that the borrower should no longer be held in default, other creditors which had declared their own loans to the borrower in default by invoking their cross-default clauses might continue to hold the borrower in default even if the initial lender stopped the default process. This could easily give rise to extensive litigation among creditors concerning their respective rights to the seized assets of the borrower.

G-2

Question: Could the Western banking system absorb a $26 billion default without any of its banks failing? The German banks are twice as exposed as their U.S. counterparts. Would any of them be in grave danger as the result of a Polish default?

Answer: The potential impact on the banking system of a "worst case" scenario (in which Poland was unwilling or unable to service its debt in the foreseeable future) involves a substantially smaller amount, since much of the $26 billion debt is owed to or is guaranteed by Western governments, and to some extent to non-banks. We lack precise data on the non-guaranteed portion of banks' claims but believe it to be on the order of $10 billion.

Absorbing a loss of this magnitude would be unpleasant to all banks involved, and particularly so to those which are heavily exposed relative to their capital. U.S. banks' exposure is modest, and none would be threatened by even a total loss. We do not have detailed knowledge of the situation of non-U.S. banks, but do not anticipate that any would suffer severe impairment of capital, even in the event of a total loss. We anticipate that, where there are problems, some provision for loss would have already been made, and that central banks might be called upon to support individual banks should the need arise.

G-3

Question: What is the best way to politicize the Polish debt? Must we be unilateral or can we call a conference of the creditor nations to provide united allied pressure? Could such a conference be expanded to deal with credit for the pipeline? Would the Europeans fear that that would be indeed what would happen?

Answer: The Polish debt situation has been politicized already by (1) the inclusion of the "exceptional circumstances" clause in the multilateral debt rescheduling agreement signed in Paris on April 27, 1981, by 15 of Poland's official creditors and (2) the refusal of the official creditors to begin 1982 rescheduling discussions until martial law is relaxed, the political prisoners released and negotiations are started between the Polish Government, the Church and Solidarity.

These decisions have been taken in the context of creditor nation conferences which have been called for the sole purpose of dealing with the debt problem. We have raised our concerns regarding the pipeline with the appropriate governments both bilaterally and multilaterally.

G-4

Question: How much control do the European governments have over their own banks? Do they have the legal power to exert political pressure on their private banks to make loans that they otherwise -- on commercial risk grounds -- might not make, for example, to finance the natural gas pipeline?

Answer: In most cases European countries do not appear to exert explicit legal control over unguaranteed lending by their banks. Some banks in European countries are owned by the public sector and thus can be subject to the influence of government officials. The recent proposals of the French Government to direct a certain amount of lending to specified sectors of its economy are a notable example of this.

G-5

Question: How would default affect Poland's access to future credit from the West? What would be its effect on East-West trade?

Answer: A formal declaration of default would have no immediate effect on the flow of credits to Poland as none are going there now. It would reinforce the existing reluctance of private western creditors to provide credits in the future because of the legal costs they would incur by attempting to seize the virtually non-existent Polish assets in the West.

However, Poland's trade with the West, which is now on a "cash and carry basis" would be interrupted by asset seizure attempts until new, third party, trading arrangements could be worked out.

East-West trade would also suffer as western lenders' perceptions of the potential risks and costs of extending export credit to the Eastern European countries would be adversely affected.

G-6

Question: It is suggested that Western leverage lies not in default itself but rather in the threat of default. By calling default, then, are we, in effect, shooting our hostage?

Answer: The threat of default exerts pressure on borrowers to repay their debts insofar as an actual declaration of default would result in the seizure of the borrower's assets and its long-term exclusion from Western capital markets. If an actual default were declared, with the resulting seizure of the borrower's assets, Western creditors would lack any additional leverage to induce the borrowers to meet their obligation. The attractiveness of the default option depends upon the ability of the borrower to make even partial payments of its debt and the amount of its assets that could be seized and applied to satisfy creditors' claims.

G-7

Question:	All of the Eastern European countries, including the Soviet Union, are facing major economic difficulties in this decade. Some have suggested that these difficulties would have arisen much sooner had it not been for the extensive Western credits supplied over the past ten years. Demand for hard currency is expected to become particularly acute especially as the needs for imported energy increase. In fact, recent accelerated gold sales by the Soviet Union do not seem to have been used to finance Polish debt payments but rather to provide the Soviet Union with needed hard currency. Aren't further credits to the Soviet bloc sending good money after bad, merely postponing and enlarging an eventual default, while at the same time helping them avoid the costs of economic adjustments?
Answer:	Credits to the Soviet Union are of two types: private unguaranteed or public, including guarantees of private lending. Our information is that private, medium-term unguaranteed lending to the Soviet Union has virtually dried-up. Public or publicly guaranteed loans continue to flow and in an effort to forestall public lending from replacing the private creditors, the U.S. Government in March initiated a series of discussions with other governments concerning the need to limit officially-backed credits to the Soviet Union. This process culminated in agreement at the Versailles Summit that the participating governments would follow, in the languague of the communique, a "prudent...economic approach to the USSR." Among the actions the Summit participants agreed to undertake pursuant to this agreement, was to handle their financial relations with the USSR cautiously, "...in such a way as to ensure that they are conducted on a sound commercial basis, including also the need for commercial prudence in limiting export credits." We view this as a broad commitment on the part of the Summit participants not to expand credits to the Soviets. We intend to use the periodic reviews of East-West economic and financial relations agreed to at the Summit to impress upon the other countries involved the seriousness with which we view this commitment.

G-8

Question:	How much would default cost the United States Government directly, in terms of the cost of honoring our guarantee obligations?
Answer:	In 1982, Poland's debt service to the U.S. Government totals $375 million. Another $325-350 million is covered under CCC guarantees. Overall, the maximum potential cost if Poland does not pay is the $1.8 billion of U.S. Government direct loans and loan guarantees.

G-9

Question: A couple of weeks ago it was announced that the Commodity Credit Corporation was going to honor $71 million of guaranteed loans of U.S. banks, without the banks having to make an official declaration of default. Have any payments actually been made to the banks yet? A similar payment was made last year in connection with the April 1981 rescheduling of Polish debt. Could you walk through the legal steps permitting such payments in absence of an official finding of default?

Answer: The Commodity Credit Corporation regulations governing its loan guarantee programs and the contract of guarantee between CCC and exporters do not require the exporter or the assignee of the exporter to declare its loan to be in default in order to receive payments from CCC under the loan guarantee contract. The guarantee-holder must merely file with CCC a notice of nonpayment, which is officially called a "Notice of Default," but which does not constitute a declaration of default. A default would occur only if the U.S. bank notified the Polish debtor (not CCC) that it was in default.

CCC offered to repurchase certain obligations it had made to guarantee loans to Poland. This offer was, in effect an offer to amend the terms of contracts previously entered into and was within the statutory authority of CCC. All of the banks and exporters accepted the CCC offer. As of May 31, 1982, CCC has made payments totaling $177 million to these creditors.

G-10

Question: How capable will the Western credit markets be of financing both the Trans Siberian Pipeline and a Trans Canadian Pipeline, particularly in 1984 and 1985 when the projects go into high gear?

Answer: The amounts involved, while large, are certainly within the capabilities of the international credit markets for normal risks. Whether banks will be willing to increase substantially their unguaranteed exposure to Eastern Europe is another question -- it seems unlikely under the present climate. However, most of the credits are expected to carry guarantees of the government of the exporting country.

G-11

Question: There have been some suggestions in the press that current lending figures to the Soviet Union for the Siberian natural gas pipeline are exaggerated, allowing the Soviets to obtain hard currency to make purchases unrelated to the pipeline. Is this indeed occurring? If so, what are the U.S. options for response?

Answer: We have heard such allegations but have seen no evidence that would support them.

G-12

Question: If Polish commercial and officially backed debt to the United States were declared to be in default, then the Polish Government, according to some analysts, would cease making payments to the U.S. entities, repaying only its obligations to the Europeans. Should such a payment be made, for example, to a West German bank, what would prevent the U.S. creditors from attaching such assets extended by the Polish Government beyond its borders?

Answer: This question raises a number of complicated questions of international law and the domestic law of other countries. Unless there were an explicit agreement between U.S. and foreign lenders to share *pro rata* any payments made to any of them by Poland, or a covenant in the loan agreement between Poland and the U.S. creditor that provided that no other creditor would enjoy priority in being repaid, it is difficult to contemplate any theory of law under which payments made to a foreign creditor could be attached by a U.S. creditor. The interpretation of such a clause or agreement would rest with the foreign court, as would questions relating to the standing of the U.S. creditor to bring a court action.

G-13

Question: Can avoidance, for political reasons, of an official declaration somehow run afoul of U.S. bank examination and accounting practices?

Answer: Internal accounting practices and examinations by independent auditors and by regulatory agencies, for the purpose of appraising the soundness of a bank's assets, entail a judgment regarding the prospects for servicing of the debt. This judgment is not directly dependent on whether the U.S. Government declares Poland to be in default, nor is a U.S.G. decision dependent upon the attitude of banks' internal practices, their independent auditors or their regulators.

G-14

Question: What are the prospects for coordinated allied managing of the Polish debt, with unified pressures and conditionality on the Polish Government?

Answer: The official creditors have been working closely together on the Polish debt problem since the fall of 1980. The most recent example of this cooperation is the January 1982 agreement by the official creditors not to enter into 1982 rescheduling discussions with Poland.

Congressional Research Service
The Library of Congress
Translation (Polish)

Washington, D.C. 20540

Tokyo, August 5, 1981

[Taking advantage of someone going to Warsaw; to be delivered to the addressee personally]

Comrade
Jozef Czyrek
Member of the BP [Politburo]
Secretary of the KC PZPR [Central Committee of the Polish United Workers' Party]
Minister of Foreign Affairs
WARSAW

I have taken the liberty of sending you enclosed my "Proposals" on the subject of outside financial sources for Poland's economic growth.

I have also forwarded copies of my "Proposals" to the comrades Zbigniew Madej, Marian Krzak, Ryszard Karski and Tadeusz Olechowski.

Yours truly,

signed
Zdzislaw Rurarz

CRS - 2

Letters of [following word illegible] with the exception of the last sentence have been sent to:

Comrade Vice Premier
Zbigniew Madej
Chairman of the State
Planning Commission

Comrade
Maria Krzak
Minister of Finance

Comrade
Ryszard Karski
Minister of Foreign Trade

Comrade Tadeusz Olechowski
Vice Minister of Foreign Affairs

CRS - 3

Zdislaw Rurarz Tokyo, July 1981

PROPOSALS WITH REGARD TO CHANGES IN THE PROFILE OF POLAND'S INDEBTEDNESS

I / Generalities

The proposals as indicated below are the result of profound and extended thoughts of mine. However, I have come forward with them only now after looking through the government report prepared in April 1981 and submitted to the Western creditor countries in Paris under the title "Report on Economic and Payments Situation of Poland." I received this report * on July 16, 1981 only and after acquainting myself with its contents I decided to turn to the above-mentioned authorities with my "Proposals."

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* I have heard critical remarks on the report from the Japanese. As a matter of fact, it is written in unprofessional language and in poor English. In addition, the arrangement of the tables and their explanations are not first class. There are also errors in the figures. The report as such cannot generate trust in our contentions.

The undersigned has not made it his business to polemize against the report, but to only present another alternative in this matter.

Among the four principal factors about the feedback contained in the "vicious circle" in our economy, that is the lack of raw materials, the "noose of indebtedness," the collapse of investments and the pressure of inflation, the "noose of indebtedness" is the toughest problem to handle because the resolutionof this problem is to a significant or even decisive degree outside of our jurisdiction.

Furthermore, the level and, in particular the profile of our indebtedness - I am not talking now about the perspectives of further debts - must provoke profound reflections.

What is more, too simplified an approach to this problem might give rise to many very profound complications in the entire development of our economy and lead to an even bigger breakdown than the one with which we are faced at present.

For this reason, this matter compels us to boldly face the future of our economy from the point of view of the role played by outside sources for the financing of our growth.

II / The Role of Outside Sources in the Financing of Poland's Growth

To supplement one's own accumulation of [capital] with the influx of funds from outside has been and still is a natural phenomenon in the history of the world's economic development. The use of outside financial sources must not be equated with a weakening of the debtor's economy. We must not forget that Denmark today is as far as indebtedness per capita is concerned the most indebted country in the world, although it belongs to the most industrialized countries. Its various foreign debts exceed $20 billion.

In the past, the United States, Russia made liberal use of external financial sources. This also applies to Germany which took advantage of the contributions it levied on France after the latter's defeat in 1871, to Japan that likewise exacted large sums from China at the end of the 19th century and to many other countries.

Even now this procedure is being applied although in different forms.

Thus, for example, the United State is the world's biggest debtor when we take the so-called [floating?] dollar into account whose value we cannot accurately calculate. This is nothing else than an indebtedness on the part of the United States toward the rest of the world where there is no guaranty as far as the repayments are concerned - from the viewpoint of separation of the dollar from gold. Besides, the mechanism of international transactions is shaped in such a manner that some countries have surpluses and others have deficits. Thus, in order to enable this mechanism to operate it also needs a so-called compensatory mechanism in the form of broadly conceived international credits.

What is more, the creditor nations usually live from the others' debts and are not at all frightened by requests for credits; the only thing that terrifies them is the debtors' nonfulfillment of their obligations toward them. However, as long as they meet their obligations, they will always have access to international credit. The creditor nations are, of course, interested in the employment of free capital. Therefore, it would be bad if all debtor countries were to start paying back their obligations and desist from contracting additional debts. This would bring about a capital surplus which would result in a so-called critical deflation.

As for Poland's debts, I may say that the whole problem is not their total sum but their profile and the fact that so far outside sources for the financing of our growth have been used with very little effectiveness.

At present, we cannot extricate ourselves from the "noose of indebtedness" other than by looking for a way of how to postpone the repayment of our installments and percentages and [contracting] further debts.

This is immediate action and, besides, the only appropriate way in our situation.

However, the question arises here - namely, what will it be later on, that is after 1985? According to the table on page 36 of the report, our indebtedness will reach its peak in 1985 - $33.5 billion - and then start dropping until it levels off at $22.9 billion in 1990.

The most important thing here is that Poland's reduction of its liabilities is taken as a premise, but in an entirely unrealistic manner. Thus, for instance, the report assumes that in 1985 Poland's national income will reach its 1980 level.

This, indeed, may be the case, but not on the basis assumed.

If the national income in this period remained stagnant and the exports to the capitalistic countries calculated in fixed prices likewise remained stagnant - in reality, on the basis of the current prices it would have to increase by 8.3% annually, while the report, on the other hand, anticipates an 8% increase in those prices - imports based on fixed prices would have to drop in this period by about 6% annually.

This does not seem to be possible. The so-called flexibility of our income from imports from the capitalistic countries fluctuates in Poland between 1 : 1.5. In this case, the flexibility would drop considerably below 1.

It is therefore doubtful whether in such a situation we would succeed in reaching in 1985 the national revenue level of 1980.

There exists a great possibility that the level reached in 1985 will, therefore, be significantly lower than the one in 1980. Even a cut in investments and in grain imports will not justify any optimism.

As a result, even a minimum growth in volume in our exports discussed would most likely be impossible to achieve unless there were again an even minimum growth in our imports from the capitalistic countries. Likewise it would be obviously impossible for us to change our negative $0.8 billion trade balance with the capitalistic countries in 1980 to a positive balance of $2.2 billion in 1985 as assumed in the report.

In the best case, we might count on balancing our turnovers since otherwise the sacrifices made by the economy as a result of the "import depression"with the capitalistic countries would be too high.

If this is so, it would likewise be impossible to slow down the speed of our indebtedness which, according to the report's assumption, would fall from $3.2 billion in 1981 to $0.8 billion in 1985.

As a result, the level of our indebtedness in 1985 might be higher than assumed in the report, that is by about $5 to 6 billion.

It is much more probable that assumptions pertaining to exports and imports in our transactions with the capitalistic countries as shown in the tables on page 37 are too little convincing and, furthermore, extremely scanty in substance. Thus, for example, for 1985, the positive balance for Poland in connection with its transactions in "industrial products" is assumed to be $140 million, although it was still negative in 1980 ($763 million). On the other hand, the balance for semi-manufactured products should have been negative ($30 million only), although in 1980 the negative balance was $604 million.

In both cases we thus would move in 1985 to a positive balance of $110 million, although the negative balance in 1980 was $1,367 million.

It does not look as if our economy in the course of five years would suddenly become an industrial economy to the extent that we would obtain a surplus in our transactions with the capitalist countries, in particular, because in our industrial production we have to focus on products that are economical both in materials and energy that is those products which up to now had been the "essentials" in our exports to the capitalist countries.

For this reason, we have to look realistically at the things as they are and assume a higher level of our indebtedness that the $5 to 6 billion indicated in the report.

In order for us to regain our "credibility as partners" we would fare better by revitalizing our production by means of increased imports from the capitalistic countries than through suffocation which, without doubt, would exclude such a revitalization in the future.

However, the major problem is what will happen in the period after 1985.

The report is going too far in its optimism. For instance, it does not indicate what the speed of our development after 1985 will be.

Instead it gives us the speed of the growth of our exports to the capitalistic countries and our imports from there. Even an average economist of a creditor country analyzing our report would hardly trust it because of its lack of correlation.

As for the speed of our exports, the reports speaks of an annual increase of 14% - 6% in volume and 8% in prices.

From previous experiences it would result - the coefficient of flexibility in export revenues - that our national revenue would have to increase yearly by about 5%, which the report obviously does not mention.

Another coefficient, if there were to be one, has not been indicated nor explained.

The report does not show what the acceleration in the growth of our exports to the capitalist countries should be. Probably such an acceleration would, however, have to be preceded by an increase in investments in our national revenue and also in the investment of imports and those of supplys - in this case, as for our transactions with the socialist countries as indicated on page 38, our imports should be decreasing in speed with regard to exports.

However, the report assumes an inverted situation with regard to our imports from capitalistic countries. During the period 1986 to 1990 imports would have to increase from only $9.7 billion to $16.1 billion in current prices, that is, by about 10.7% annually. Calculating, on the other hand, in fixed prices - incidentally, in paragraph 26 on page 33 the report attributes that the 8% increase in yearly imports is due to the increase in prices - this increase, therefore, would be about 2.7% annually.

From this we may infer that the share of our imports from capitalistic countries would get smaller as far as the growth of our national revenue is concerned. From the traditional coefficient of flexibility of import revenues it would drop from 1 : 1.5 to about 1 : 0.6. It appears that this is entirely impossible.

Anyway, this thesis is indirectly disputed also by the report. Thus, for instance, in the table in Paragraph 26 on page 33 the speed of the increase in imports from the capitalistic countries for the period 1986 to 1990 is given - the table itself is very ineffective because the year of 1986 that is, the point of departure, is given in fixed prices. The speed is indicated as 6.4% yearly for the period 1987 to 1990. Taking thus into consideration the weak increase in the 1986 imports - which can easily be figured out indirectly - the average increase in the volume of those imports would thus be 5.5% for the period 1986 to 1990.

If according to the further assumptions in the report the speed of the price increase for imports from the capitalist countries for the period 1986 to 1990 is 8% annually, the increase in imports based on the current prices would not be 10.7%, as stated in the report, but approximately 13.5%. In this case, the import level from capitalistic countries in 1990 would not be $16.1 billion, as indicated in the tables on page 36, but more than $18.2 billion.

It is clear that the positive balance of the trade balance with the capitalistic countries in 1990 of $6.7 billion would in reality be $4.6 billion. Even not taking into account other reservations of mine with regard to the speed of the increase in our exports as well as the conception of a higher balance in our transaction with the capitalists countries, our ability to clear our debts would at least be by 1.3 less than indicated in the report. But this is not the most important thing.

The acceleration of Poland's growth must happen some day. Even if the national revenue in 1985 reaches the 1980 level, it still will be lower than in 1978, that is about 15% lower per capita.

The maintenance of the share of investments in the national revenue on the 12 to 14% level would hardly be sufficient for the mortgage regeneration of our permanent property. There have not been any talks about such chances for our country's growth in the foreseeable future.

Since, therefore, higher investments in our national revenue must be made sooner or later, the expenses for our consumption must be reduced in the first period. If, furthermore, the country's clearing of its indebtedness is supposed to begin in the period specified in the report, the national revenue for distribution would be subject to an additional reduction which with the increase in the share of the investments in the national revenue already diminished by the part paid abroad would reduce consumption even more. Assuming the increase in the country's population, the drop in per capita consumption would be significant for that period.

It is not difficult to imagine how the people would feel. Particularly the drop in consumption would happen in a period of the economy's revitalization which always causes an increase in consumption tendencies. Besides, the increase in production would perhaps be caused by the increase in work productivity which probably would have to be on the premise of a wage increase as a stimulus.

Well, that concept contained in the report, the so-called concept of Poland paying off its debts after 1986 appears to be entirely unrealistic.

Therefore, we have to consider another alternative.

I personally would like to say that there are even two alternatives.

1. Maintenance of the level of indebtedness from 1985 which would be higher by $5 to 6 billion than that indicated in the report at least until 1990.

2. Continued increase in the indebtedness until 1986 by new credits, thus increasing the level of indebtedness by another $10 to 12 billion, that is, to about $50 billion in 1990.

However, in both cases the profile of that indebtedness would have to suffer a radical change in the nearest future.

Depending on the speed in the change of the profile of indebtedness, I would be more in favor of the first alternative.

If the profile were to remain almost the same - in 1985 as it is now - then I opt for the first alternative - on the principle that there is no other way out.

If, on the other hand, the profile has to be changed, then I would favor the second alternative.

As for the change in the profile of indebtedness, I would mainly devote my "proposals" to that problem.

III / My Proposals with Regard to the Change in Profile of Poland's Indebtedness

Most of all, I wish to emphasize that any strategy pertaining to Poland's growth together with the role which in this connection plays outside financial sources after 1985 are decisively determined by the development of the situation in the period 1981 to 1985.

It is already evident now that until 1985 we cannot only give any thought to the repayments of installments and percentages of our debts but that we must, as in the past, put up with our indebtedness.

It is possible that these two factors will not solve our problem that is the phenomenon of stagflation, that is, stagnation tied to inflation.

What Poland needs is somehow a dramatic improvement in its situation so that the "vicious circle" can be broken.

In spite of all improvements such a thing will not be successful unless there is action from outside. Our economy is too much out of tune and the paradox of the situation lies in the fact that an improvement must be preceded by a further worsening of the situation, if such an improvement were limited only to internal action.

The real dramatic chances for an improvement of the situation reside, therefore, only in help from the outside. I am now not speaking of credits but of not repayable aid in the form of food, raw materials, medicine and other industrial products such as artificial fertilizer, plant preservation agents, means of transportation, tractors and a large number of machines. Finally, this aid may be in the form of highly advantageous government credits or those from international organizations such as IMF, the World Bank, etc.

In other words, we need help in the form of a "miniature Marshall Plan" in the amount of approximately $3 to 4 billion until 1985 and other credits in the amount of $2 to 3 billion.

In my opinion such aid is possible. As a matter of fact, we have world surpluses in grain for bread and feeding, edible fats, meat, cotton, certain metals and there are also free productive forces that could easily meet the needs for products and semi-finished articles.

It is obvious that this type of aid must have the characteristics of government aid.

It is highly likely that the USSR together with other governments of the capitalistic countries might step forward for the enactment of such a "plan;" it might, however, accept some unilateral obligation for aid.

This matter, however, would have to be carried out mainly by the Western industrialized countries.

It is quite obvious that this entire problem is highly political.

And precisely for this reason it has chances to succeed. The pronouncement on our part must, of course, be from the highest level and, on the other hand, those negotiations would have to be tied to certain conditions, particularly, in the sphere of development strategy and tactics.

Nevertheless, we have to recognize that the existence of the Nation is at stake here and that for this reason no price can be too high.

Such aid would surely give us a "big push" and get us out of the "vicious circle" of economic stagnation; it would create the conditions for a normal and fast development after 1985.

Returning to the topic of our strategy of profiting from outside financial sources after 1985, I would declare myself in favor of the second previously mentioned alternative, that is, continuation of our indebtedness but on the condition that its profile be radically changed.

Concretely speaking, we deal here with changes in indebtedness with banks by direct investments of the productive type. In other words, it involves the admission of foreign productive capital - we already permitted financial capital - for the purpose of getting our economy in our country active.

This whole matter requires a few words of explanation. The production process in the world is getting more and more "internationalized." In the nonsocialist world it occurs in the form of action by "world corporations," and in the socialist world in the form of "production specialization" within the framework of COMECON. In any case, in the nonsocialist world more than 2/3 of the international transactions are directly controlled by those "world corporations," and generally 1/3 of those transactions are exchanges between mother corporations and their subsidiaries or with the same branches.

Thus a very profound international division of labor occurred where the changes in industrial products have grown the fastest, that is, precisely in semi-finished products, sub-assemblies and exchange parts. Such a "distributed" production is significantly cheaper. Here the effects of investments are achieved quicker; there is the "economy of mass production," the guaranty of a distributors' net and it is quite clear that the scientific, technical and organizational process is easier.

The best developed and, at the same time, the economically most effective forms of capital investments are the previously mentioned direct productive investments. It is true, that it entails here a transfer of profits to foreign countries, but this must be preceded by an influx of capital as such and an ensuing profit must be materialized so that it can be transferred.

What is more, if there are perspectives for higher profits, the profits of the subsidiaries are reinvested but they will also stimulate the influx of new capital.

Thus, for instance, the transfer of profits to the United States in 1979 from their direct investment was $17.1 billion, but its direct total investments increased in 1979 by almost $25 billion.

I should add here that direct U.S. investments in 1979 were $193, those by England almost $55, the Republic of Germany approximately $36 billion whereas those by Japan amounted to $17.2 billion.

As far as Japan is concerned, it anticipates its direct investments in 1990 to rise to $150 billion. In the meantime, the investments made by the United States, Great Britain, France and many other countries will also increase.

In 1979, the total of direct investments in the world is anticipated to be $400 billion.

In this connection I would like to add that the productive value of such investments exceeds their amounts normally by two to three times. For instance, in England about one fourth of the production is in the hands of foreign capital that is mostly U.S. Here the mutual diffusion of direct investments is very widespread. Likewise, the United States is a place for the expansion of foreign capital and recently, in particular, that of Japan. The "world corporations" of the United States, for instance, plan to invest in Western Europe alone about $24.5 billion in 1981 of which up to $3.7 billion in England and the Federal Republic of Germany each of which are significant sums even for those countries. In Australia the influx of private capital in this year is $7.8 billion.

We may even venture to state that today a highly industrialized country cannot remain in complete isolation as far as foreign capital is concerned. Certain exceptions from this rule will not repeat themselves in the future. The level of scientific, technical and organizational level of work and, most of all, international exchanges are already of such a type that they would be too expensive for certain "independent" premises of future growth. Here "increasing interdependence" is the imperative for this type of progress in general and the subjects in this interdependence are first and foremost the previously mentioned "world corporations" supported by the "world banks."

This is so much more true when we speak about another process of recent occurrence, that is something that followed the example of the "cartelization of world cooperations." They replaced competition by various agreements especially in the field of scientific, technical cooperation and market division. Thus, for instance, the idea of the "world car" is getting materialized that is a car many parts and subassemblies of which will be interchangeable regardless of the car's make. There is no doubt that similar "world products" will be on the increase. Besides, the establishment of a network of such producers may, indeed, close down the roads to the world market.

Poland, as an industrial country, in its decision to participate in industrial products for export has no other alternative but to look for close ties with the "world corporations." If so, we are faced with the problem of how to go about it.

Most of all, we must break the "psychological barrier" of direct foreign investments. The fear of placing our economy under the tutelary of powerful "world corporations" is rather more theoretical than practical. A plant working under a foreign shop sign definitely looks better than one messed up in "frozen investments" or one shut down because of a lack of raw materials or others.

Of course, economies opened by direct investments will require a lot of changes in our management system - with regard to the broad direction of the application of market mechanism - and in our legislation.

This, however, is a subject I, obviously, will not touch on in my "Proposals."

On the other hand, it deals with the same principle, namely, how to start this entire process and how to go on with it.

Well, in our concrete situation we at first, would have to accept the principle that we are ready to completely or partially change our present indebtedness to investments by "world corporation," of course, with the agreement of the present creditors, that is the governments and trade banks. This means that the current creditors would loan their amounts to those corporations.

Concretely stated, we have to see to it that there will be no transfer of a part of our national revenue in the form of repayment of installments and percentages.

In exchange, we might anticipate the transfer of sums to selected fields of our economy as direct investments of the "world corporations." The interested "world corporation" would, thus, take the appropriate sums from the present creditors under conditions agreed upon among them and with us as indirect and direct participators as far as the direction of these investment sums is concerned.

Of course, the detailed negotiations here might be very complex but after all, let us not forget the issue is that such a possibility offers itself to us.

If it were to succeed - theoretically the chances here are good - then the profile of our indebtedness would have to change at the same time as a result of which we might extricate ourselves from that "noose" of stiff repayments of installments and percentages. Thus, our indebtedness would be tied to our economy as this takes place with direct investments in general. We would be threatened only by the transfer of profits but before this happens there must be profits - surely through the export of free currencies. If this operation is carried out, we may be faced with the perspective of the reinvestment of profits from investments and the influx of new capitals; then even the transfer of profits might not have a negative effect on our balance of payments.

I would like to point out that we should accept even the possibility of the existence of the so-called 100% subsidiaries, that is those completely owned by the "world corporations" as for instance Coca Cola, even on the basis of "enclaves" in our economy, in particular, if that subsidiary has an outstanding "export profile."

If this happens, that very level of Poland's indebtedness would with the change of the profile become a problem of third order even if it were to increase to no matter what proportions. After all, there would no longer be any stiff payment obligations. The transfer of profits, in the event of difficulties in the balance of payments could be regulated with means known all over the world. However, other transfers must not take place. Of course, the investments would be binding and must be subject to sale prior to the transfers - on the basis of local rules - which changes the whole shape of things.

To put it in a nutshell, this is the only way out not only as far as the "noose of indebtedness" is concerned, but at the same time through the activation of foreign capital for the growth of Poland by following the example of other countries. In this manner, we would profit not only from outside financial sources for the good of our growth, but at the same time we would solve the troublesome problem of how to clear our debts - for which even this report sees no chance.

IV / Concluding remarks

I would like to point out that the traditional method of how to resolve our economic problems to which I count the "classical credit" and its service - no longer have any chances of success.

Therefore, we have to seek unconventional solutions where outside financial sources may henceforth play a decisive role in our growth.

To say it plainly, Poland cannot permit itself now and in the future not to take advantage of outside financial sources and so much more with regard to the repayment of its current indebtedness in the traditional manner.

For this reason we have to look for new alternatives which amont other things are private direct investments by the "world corporations."

Zdzislaw Rurarz

Translated by
Paul Vidal
CRS - Language Services
7/2/82 - amc

Washington, D.C., June 23, 1982.

Mr. Wayne Abernathy
Committee on Banking,
Housing and Urban Affairs
U.S. Senate
Washington, D.C., 20510

Dear Mr. Abernathy,

As requested by you I mail you a photocopy of my "Proposals" which I wrote in July 1981 and sent to Warsaw on August 5, 1981. The "Proposals" were addressed to Mr. J. Czyrek, Politburo Member and the Minister for Foreign Affairs. The copies were sent to Mr. Z. Madej, Vice-Premier and the Chief of the State Planning Commission, to Mr. M. Krzak, the Minister of Finance, to Mr. R. Karski, the Minister for Foreign Trade and to Mr. T. Olechowski, the Vice-Minister of Foreign Affairs.

As far as I know the "Proposals" were widely read in the ruling circles / Jaruzelski including/, as well as alsewhere.

Since you wanted the Polish text I should only explain to the translator tha "KK" means "kraje kapitalistyczne", a term widely used, in fact corresponding to hard-currency countries.

I would be glad to provide you with some other explanations/ tel.476 5247/.

If this text would be of some use I would be really happy.

Sincerely yours,

Zdzislaw M. Rurarz
former Ambassador of Poland
to Japan

1 enclosure

Tokio, 5 sierpnia 1981 r.

okazją
/do rąk własnych/

Towarzysz
Józef Czyrek
Członek BP, Sekretarz KC PZPR
Minister Spraw Zagranicznych

Warszawa

W załączeniu pozwalam sobie przesłać swoje "Propozycje" dot. korzystania z zewnętrznych źródeł finansowania rozwoju gospodarczego Polski.

Kopie "Propozycji" przesyłam także Tow.Tow. Zbigniewowi Madejowi, Marianowi Krzakowi, Ryszardowi Karskiemu i Tadeuszowi Olechowskiemu.

Z wyrazami szacunku,

Zdzisław Rurarz

[redacted]

Pisma przewodnie /z wyj. ostatniego zdania/ do:

Towarzysz Wicepremier
Zbigniew Madej
Przewodniczący Komisji Planowania
przy Radzie Ministrów

Towarzysz
Marian Krzak
Minister Finansów

Towarzysz
Ryszard Karski
Minister Handlu Zagranicznego

Towarzysz
Tadeusz Olechowski
Podsekretarz Stanu w Ministerstwie
Spraw Zagranicznych

Tokio, lipiec 1981 r.

Zdzisław Rurarz

PROPOZYCJE DOTYCZĄCE ZMIAN W PROFILU ZADŁUŻENIA POLSKI

I / Uwagi ogólne

Przedłożone poniżej propozycje są wynikiem gruntownych i długotrwałych moich przemyśleń. Jednakże występuję z nimi dopiero w chwili obecnej, gdyż skłonił mnie do tego rządowy Raport opracowany w kwietniu 1981 r. i przedłożony zachodnim krajom wierzycielskim w Paryżu /Report on Economic and Payments Situation of Poland/. Raport[x/] ten otrzymałem dopiero 16 lipca 1981 r. i po zapoznaniu się z jego treścią postanowiłem zwrócić się do najwyższych władz z w/w "Propozycjami".

Zadaniem niniejszego nie jest jednak polemika z Raportem, a jedynie przedstawienie w stosunku do niego innego wariantu koncepcji.

Z pośród czterech głównych czynników o sprzężeniu zwrotnym, które składają się na "błędne koło" naszej gospodarki, tj. brak surowców, "pętla zadłużenia", krach inwestycyjny i presja inflacyjn - najtrudniejszym problemem do rozwiązania jest "pętla zadłużenia". Rozwiązanie bowiem tego problemu leży w znacznym stopniu , jeśli nie decydującym, poza naszą juryadykcją.

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x/ od Japończyków słyszałem krytyczne uwagi na temat Raportu. Istotnie, napisany on jest niefachowym językiem i złą angielszczyzną. W dodatku układ tabel i ich objaśnienia nie są najlepsze. Są też błędy liczbowe. Raport taki nie może tworzyć zaufania do naszych argumentów.

Ponadto poziom, a zwłaszcza profil naszego zadłużenia, nie mówiąc już o perspektywie dalszego zadłużania się - musi wywoływać głębokie refleksje.

Co więcej, zbyt uproszczone podejście do tego problemu może wywołać wiele bardzo głębokich komplikacji w całym naszym rozwoju gospodarczym, łącznie z jeszcze większym załamaniem się naszej gospodarki niż to ma miejsce obecnie.

Stąd też sprawa wymaga śmiałego spojrzenia na przyszłość naszej gospodarki, z punktu widzenia roli zewnętrznych źródeł finansowania naszego rozwoju.

II/ Rola zewnętrznych źródeł finansowania rozwoju Polski

Uzupełnianie własnej akumulacji dopływem funduszów z zewnątrz było i jest zjawiskiem normalnym w historii rozwoju gospodarczego świata. Posiłkowanie się zewnętrznymi źródłami finansowania nie musi być równoznaczne ze słabością gospodarczą dłużnika. Nie należy zapominać, że dziś najbardziej zadłużonym na głowę mieszkańca krajem w świecie jest Dania, która jednocześnie należy do ścisłej czołówki krajów ekonomicznie najwyżej rozwiniętych /jej dług zewnętrzny pod wszelką postacią przekracza 20 mld. dol./.

W przeszłości z zewnętrznych źródeł finansowania korzystały szeroko USA, Rosja, Niemcy /częściowo w formie kontrybucji nałożonej na zwyciężoną Francję w 1871 r./, Japonia /częściowo kontrybucja nałożona na Chiny pod koniec XIX w./ oraz wiele innych krajów.

Nawet i obecnie proces ten trwa, choć różne są jego formy.

Tak np. największym dłużnikiem świata są USA, jeśli uwzględnić tzw. nawis dolarowy /którego nawet nie można dokładnie obliczyć/, który jest niczym innym jak długiem USA wobec reszty świata i to bez gwarancji jego spłaty /ze względu na oderwanie się dolara od złota/. Mechanizm obrotu międzynarodowego jest zresztą tak ukształtowany, że są tu kraje tzw. nadwyżkowe i deficytowe. Po to, żeby ten mechanizm działał potrzebny jest mu także tzw. mechanizm wyrównawczy w postaci szeroko pojętego kredytu międzynarodowego.

Co więcej, kredytodawcy zwyczajnie żyją z długów innych i wcale ich nie przeraża popyt na kredyt, a jedynie przeraża ich niewywiązywanie się dłużników ze zobowiązań wobec nich. Jak długo jednak wywiązują się oni ze swych zobowiązań, tak długo mają dostęp do kredytu międzynarodowego. Kredytodawcy są bowiem zainteresowani w "zatrudnianiu" wolnego kapitału. Byłoby więc źle, gdyby raptem wszyscy dłużnicy zaczęli spłacać swoje zobowiązania i nie chcieli kontynuować dalszego się zadłużania. Powstałby wtedy nadmiar wolnego kapitału, a co za tym idzie efekt tego byłby deflacyjny, tj. kryzysowy.

Co się tyczy zadłużenia Polski, to cały problem polega nie na samej jego wysokości, a na jego profilu oraz bardzo słabej dotąd efektywności wykorzystania zewnętrznych źródeł finansowania naszego rozwoju.

W chwili obecnej wyzwalanie się z "pętli zadłużenia" nie jest możliwe inaczej niż przez szukanie dróg odroczenia spłat rat i procentów oraz dalsze zadłużanie się.

Jest to działanie doraźne i jedynie zresztą słuszne w naszej sytuacji.

Powstaje jednak pytanie - co dalej, tj. po 1985 roku? Raport na str. 36 /tabela/ podaje, że zadłużenie nasze osiągnie szczyt w 1985 r. /33,5 mld. dol./ i potem zacznie spadać osiągając poziom 22,9 mld. dol. w 1990 r.

Najważniejsze jest tu to, że w ogóle zakłada się oddłużanie Polski. W dodatku w sposób zupełnie nierealny.

Tak np. Raport zakłada, że dochód narodowy Polski w 1985 r. osiągnie poziom z roku 1980-tego.

Tak istotnie może być, ale też chyba nie przy podanym założeniu.

O ile dochód narodowy w tym okresie byłby stagnacyjny, a eksport do KK liczony w cenach stałych również /co prawda miałby on wzrastać w cenach bieżących o 8,3% rocznie, zaś 8% rocznie Raport przewiduje jako wzrost samych cen/, to import w cenach stałych spadałby w tym czasie o ok. 6% rocznie.

Nie wydaje się, aby to było możliwe. Tzw. elastyczność dochodowa importu z KK waha się w Polsce w wysokości ok. 1 : 1,5 . W tym przypadku elastyczność ta spadłaby znacznie poniżej 1.

Wątpliwe jest więc, czy w takiej sytuacji udałoby się osiągnąć w 1985 r. poziom dochodu narodowego z 1980 r.

Istnieje duże prawdopodobieństwo, że poziom osiągnięty w 1985 r. byłby zatem znacznie niższy niż w 1980 r. Ani cięcia inwestycyjne, ani w imporcie zbóż - nie usprawiedliwiają zakładanego optymizmu.

W konsekwencji tego również nawet minimalny przyrost omawianego eksportu w wolumenie byłby najprawdopodobniej niemożliwy do uzyskania bez również choćby minimalnego przyrostu importu z KK. Oczywiście niemożliwe byłoby także przejście z ujemnego salda bilansu handlowego z KK w wys. 0,8 mld. dol. w 1980 r. na dodatnie w wys. 2,2 mld. dol. w 1985 r., jak to zakłada Raport.

W najlepszym przypadku można tu liczyć na zbilansowanie się obrotów, gdyż inaczej ofiara poniesiona przez gospodarkę w wyniku "depresji importowej" z KK byłaby zbyt wysoka.

Jeśli tak, to również niemożliwe będzie osłabianie tempa naszego zadłużania się, co zakłada Raport /z 3,2 mld. dol. w 1981 r. spadek do 0,8 mld. dol. w 1985r./.

W rezultacie poziom naszego zadłużenia w 1985 r. może być wyższy niż to zakłada Raport / o ca. 5-6 mld. dol./.

Jest to tym bardziej prawdopodobne, że założenia eksportowo-importowe w naszych obrotach z KK podane w tabeli na str. 37 są zbyt mało przekonujące /ponadto niezwykle ubogie w treść/. Tak np. na rok 1985 zakłada się dodatnie dla Polski saldo w obrotach "wyrobami przemysłowymi" w wysokości 140 mln. dol., choć jeszcze w 1980 r. było ono ujemne w wys. 763 mln. dol. Saldo zaś w wymianie półproduktów miałoby być ujemne w wys. tylko 30 mln. dol. odpowiednio, choć w 1980 r. było ono ujemne w wys. 604 mln. dol.

W ogóle zaś łącznie w obu pozycjach przeszlibyśmy więc w 1985 r. na saldo dodatnie w wys. 110 mln. dol., choć jeszcze w 1980 r. było ono ujemne w wys. 1.367 mln. dol.

Nie wydaje się, aby nasza gospodarka stała się przemysłowo raptem tak prężna w ciągu 5 lat, że mogłaby mieć nadwyżki w obrotach w/w pozycjami z KK. Zwłaszcza że w produkcji przemysłowej mamy się nastawiać na wyroby energo- i materiałooszczędne, które dotąd były "rdzeniem" naszego eksportu wyrobów przemysłowych do KK.

Stąd też trzeba realnie spojrzeć na sytuację i z góry założyć większy poziom naszego zadłużenia o ca 5-6 mld. dol. niż jest to w Raporcie.

- Odzyskanie przez nas "wiarogodności partnerskiej" możliwe będzie raczej przez ożywianie się naszej produkcji, także przy pomocy zwiększonego importu z KK, niż przez jego duszenie, co niewątpliwie odsunie w przyszłość samo ożywianie się jako takie.

Główny jednak problem, to okres po 1985 r. Raport idzie tu w swym optymiźmie zbyt daleko. Nie podaje on np. jak miałoby się kształtować tempo naszego rozwoju po 1985r.

Natomiast podaje tempo przyrostu eksportu do KK i importu stamtąd. Nawet dla przeciętnego ekonomisty w kraju wierzycielskim analizującego nasz Raport taki brak korelacji nie może wzbudzać zaufania do niego.

Co się tyczy tempa eksportu, to podano go na ca 14% rocznie /6% przyrost wolumenu i 8% przyrost cen/.

Z doświadczeń przeszłości wynikałoby /współczynnik elastyczności dochodowej eksportu/, że dochód narodowy musiałby wtedy wzrastać o ca 5% rocznie, czego oczywiście Raport nie wspomina. Inny współczynnik, jeśli miałby mieć miejsce, nie jest ani wspomniany ani wyjaśniony.

Z Raportu nie wynika, jak miałoby nastąpić przyśpieszenie rozwoju eksportu do KK. Prawdopodobnie jednak przyśpieszenie takie musiałoby być poprzedzone wzrostem udziału inwestycji w dochodzie narodowym, a także importu inwestycyjnego i zaopatrzeniowego /przy tym w naszych obrotach z KS na str. 38 import również miałby być malejący w tempie w stosunku do eksportu/.

Raport zakłada jednak sytuację odwrotną, jeśli chodzi o import z K.K. W całym okresie 1986-1990 miałby on wzrosnąć tylko z 9,7 mld. dol. do 16,1 mld. dol. w cenach bieżących, tj. o ca 10,7% rocznie. Licząc zaś w cenach stałych /Raport zresztą na str. 33 w par. 26 8% przyrostu rocznego importu przypisuje wzrostowi cen/ wzrost ten wynosiłby ca 2,7% rocznie.

Wynikałoby stąd, że udział importu z KK we wzroście naszego dochodu narodowego byłby malejący. Z tradycyjnego współczynnika elastyczności dochodowej importu ca 1:1,5 spadłby on do ca 1:0,6. Wydaje się to zupełnie niemożliwe.

Zresztą tezie tej pośrednio zaprzecza także sam Raport! Tak np. w tabelce w par.26 na str.33 podano tempo przyrostu importu z KK za okres 1986-1990 /tabelka bardzo nieudolna, bo 1986 rok jest tu wyjściowym w cenach stałych/. Tempo to wynosi 6,4% rocznie za okres 1987-1990. Uwzględniając zaś słaby przyrost tego importu w 1986 r. /co można łatwo pośrednio wyliczyć/ średnie tempo przyrostu wolumenu omawianego importu wyniosłoby więc ca 5,5% rocznie w okresie 1986-1990.

Zakładając dalej podane w Raporcie tempo wzrostu cen w imporcie z KK w okresie 1986-1990 na 8% rocznie, to wzrost importu w cenach bieżących wynosiłby wtedy nie 10,7%, jak podaje Raport, ale ca 13,5%. W tej sytuacji poziom importu z KK w 1990 r. nie wynosiłby 16,1 mld. dol., jak to podano w tabeli na str.36, a ponad 18,2 mld. dol.

Jasne, że podane saldo dodatnie b.h. z KK na 1990 r. w wys. 6,7 mld. dol. wyniosłoby w rzeczywistości ca 4,6 mld. dol Nawet pomijając inne moje zastrzeżenia co do wysokości tempa przyrostu eksportu, jak również samej koncepcji przejścia na wysokie saldo dodatnie w obrotach z KK, nasza zdolność do oddłużania się byłaby co najmniej o 1/3 niższa niż to zakłada Raport. Ale nawet nie to jest najważniejsze.

Przyśpieszenie rozwoju Polski musi kiedyś nastąpić. Nawet jeśli dochód narodowy kraju w 1985 r. osiągnie poziom z 1980 r., to będzie on ciągle o ca 7% niższy niż w 1978 r., a na głowę mieszkańca nawet o ca 15% niższy.

Utrzymywanie udziału inwestycji w dochodzie narodowym na poziomie 12-14% starcza zaledwie na odtwarzanie amortyzującego się majątku trwałego. Nie ma wtedy mowy o jakichkolwiek szansach rozwojowych kraju w dłuższym okresie.

Musi więc wcześniej czy później nastąpić wzrost inwestycji w dochodzie narodowym, co w początkowym okresie musi zmniejszyć fundusz spożycia. Jeśli ponadto w tym okresie miałoby nastąpić oddłużanie się kraju, jak to przewiduje Raport, to dochód narodowy do podziału uległby dodatkowo zmniejszeniu, co przy wzroście udziału inwestycji w dochodzie narodowym, zmniejszonym o część spłacaną za granicę, zmniejszyłoby spożycie jeszcze bardziej. Zakładając przyrost naturalny - spadek spożycia na głowę byłby w tym okresie znaczny.

Nie trudno sobie wyobrazić, jakie byłyby nastroje wśród ludności. Zwłaszcza że spadek spożycia następowałby w okresie ożywiania się gospodarki, co zawsze wywołuje wzrost "nastrojów konsumpcyjnych". Zresztą przyrost produkcji byłby chyba wywoływany głównie przyrostem wydajności pracy, co prawdopodobnie musiałoby zakładać z góry wzrost płac realnych jako bodźca.

Cała więc koncepcja zawarta w Raporcie, tj. koncepcja oddłużania się Polski po 1986 r. wydaje się całkowicie nierealna.

Należałoby więc rozważyć inną alternatywę.

Osobiście uważam, że są nawet dwie alternatywy:

1/ utrzymanie poziomu zadłużenia z 1985 r. /które byłoby wyższe o 5-6 mld. dol. od podanego w Raporcie/ co najmniej do 1990 r.;

2/ dalszy wzrost zadłużenia po 1986 r. o nowe kredyty, zwiększając poziom zadłużenia o dalsze 10-12 mld. dol. /do ca 50 mld. dol. w 1990 r./.

W obu jednak przypadkach profil tego zadłużenia musiałby ulec radykalnej zmianie w najbliższej przyszłości.

W zależności od tempa zmian w profilu zadłużenia wypowiadałbym się za pierwszą lub drugą alternatywą.

Jeśli profil miałby pozostać prawie ten sam /w 1985r. jak obecnie/, to opowiadam się za pierwszą alternatywą /na zasadzie, że innego wyjścia nie ma/.

Jeśli zaś profil miałby ulec zmianie, to wypowiadam się za drugą alternatywą.

Co się tyczy samej zmiany profilu zadłużenia, to zagadnieniu temu poświęcam głównie swoje "Propozycje".

III/ Propozycje zmian w profilu zadłużenia Polski

Przede wszystkim trzeba podkreślić, że jakakolwiek strategia rozwojowa Polski, łącznie z rolą w niej zewnętrznych źródeł finansowania po 1985 r., w decydującym stopniu zostanie zdeterminowana przez rozwój sytuacji w okresie 1981-1985.

W tej chwili jest już jasne, że do 1985 r. nie tylko musimy uciekać się do odraczania spłat rat i procentów naszego zadłużenia, ale także musimy nadal brnąć w zadłużenie.

Prawdopodobnie oba te fakty nie rozwiążą i tak naszego problemu, tj. zjawiska stagflacji /stagnacja połączona z inflacją/.

Polsce potrzebna jest jakaś dramatyczna poprawa sytuacji dla przełamania "błędnego koła".

Mimo wszystko poprawa taka nie ma szans powodzenia tylko poprzez wewnętrzne działania. Gospodarka nasza jest zbyt rozstrojona i paradoks sytuacji polega na tym, że poprawa musiałaby być poprzedzona dalszym pogorszeniem się sytuacji, jeśli poprawa taka ograniczona byłaby tylko do wewnętrznych działań.

Realne szanse dramatycznej poprawy sytuacji tkwią więc tylko w pomocy zagranicznej. Przy tym nie kredytach, a głównie pomocy bezzwrotnej. Zwłaszcza w postaci żywności, surowców, lekarstw i niektórych innych wyrobów przemysłowych /np. nawozów sztucznych, środków ochrony roślin, środków transportu, traktorów oraz wielu maszyn/. W ostateczności mogłyby to być wysoce korzystne kredyty rządowe lub instytucji międzynarodowych /IMF, Banku Swiatowego/.

Innymi słowy, potrzebna jest nam pomoc w postaci jakiegoś "mini-Planu Marshalla". Wysokość jego musiałaby prawdopodobnie wynosić nie mniej niż 3-4 mld. dol. do 1985 r. Oprócz tego inne kredyty musiałyby wynosić 2-3 mld. dol.

Moim zdaniem, taka pomoc jest możliwa. Zwłaszcza że w świecie są nadwyżki zbóż chlebowych i paszowych, tłuszczów jadalnych, mięsa, bawełny, niektórych metali, a także istnieją wolne moce produkcyjne, które łatwo dostarczą potrzebne wyroby i półwyroby przemysłowe.

Jasne, że tego rodzaju pomoc musiałaby mieć charakter pomocy rządowej.

Jest mało realne, że ZSRR łącznie z innymi rządami KK przystąpiłby do takiego "Planu". Mógłby jednak podjąć pewne jednostronne zobowiązania pomocowe.

Sprawa sprowadzałaby się jednak głównie do rozwiniętych krajów zachodnich.

Jest oczywiste, że cały problem jest wysoce polityczny.

Ale właśnie z tego powodu ma szanse realizacji. Wystąpienie z naszej strony musiałoby oczywiście być na najwyższym szczeblu, zaś same ewntualne negocjacje byłyby zapewne obłożone różnymi warunkami, zwłaszcza w dziedzinie strategii i taktyki naszego rozwoju.

Niemniej jednak biorąc pod uwagę fakt, że chodzi tu o istnienie Narodu - żadna cena nie może być zbyt wysoka.

Pomoc taka byłaby zapewne "wielkim pchnięciem", które wyrwałoby nas z "błędnego koła" marazmu gospodarczego i stworzyło warunki na względnie normalny i szybki rozwój po 1985 r.

Powracając do tematu naszej strategii korzystania z zewnętrznych źródeł finansowania po 1985 r. opowiadam się za drugą w/w alternatywą, tj. kontynuowaniem dalszego zadłużania się, ale przy radykalnie zmienionym jego profilu.

Mówiąc konkretnie, chodziłoby o zmianę zadłużania się z "bankowego" na bezpośrednie lokaty typu produkcyjnego. Innymi słowy, chodziłoby o dopuszczenie obcego kapitału produkcyjnego /finansowy już dopuściliśmy/ do działalności gospodarczej na naszym terenie.

Cała sprawa wymaga kilku słów wyjaśnienia. Otóż proces produkcji w świecie podlega coraz głębszemu "umiędzynaradawianiu się". W świecie niesocjalistycznym przybiera to formę działalności "korporacji globalnych", zaś w socjalistycznym "specjalizacji produkcji" w ramach RWPG. W każdym razie w świecie niesocjalistycznym ponad 2/3 obrotów międzynarodowych jest bezpośrednio kontrolowane przez owe "korporacje globalne", a w ogóle 1/3 tych obrotów to wymiana między korporacjami macierzystymi a ich filiami, czy samymi filiami.

Nastąpił więc bardzo głęboki międzynarodowy podział pracy, który charakteryzuje się tym, że najszybciej rośnie wymiana w wyrobach przemysłowych, a ściślej w półwyrobach, podzespołach i częściach zamiennych. Tak "rozkooperowana" produkcja jest zwyczajnie tańsza. Szybciej osiąga się tu efekty inwestycyjne, występuje "ekonomia masowej produkcji", zapewniona jest sieć dystrybucyjna i rzecz jasna łatwiejszy jest postęp naukowo-techniczny i organizacyjny.

Najbardziej rozwiniętą i jednocześnie ekonomicznie najbardziej efektywną formą lokat kapitałowych są wspomniane produkcyjne lokaty bezpośrednie. Prawda, że następuje tutaj transfer zysków za granicę, ale przedtem musi być napływ kapitału jako takiego, a następnie sam zysk musi się zrealizować, żeby można go było transferować.

Co więcej, w przypadku perspektyw większych zysków nie tylko zyski filii są reinwestowane, ale stają się bodźcem dla napływu nowych kapitałów.

Tak np. transfer zysków do USA w 1979r. od ich lokat bezpośrednich wyniósł 17,1 mld. dol., ale ich globalne inwestycje bezpośrednie wzrosły w 1979r. prawie o 25 mld. dol.

W ogóle warto dodać, że lokaty bezpośrednie USA w 1979 r. wynosiły 193 mld. dol., Anglii prawie 55 mld. dol., RFN ca 36 mld. dol., zaś Japonii 17,2 mld. dol.

Co się tyczy Japonii, to przewiduje ona, że w 1990 r. jej lokaty bezpośrednie mogą osiągnąć aż 150 mld. dol. W międzyczasie wzrosną też lokaty USA, WB, RFN, Francji i wielu innych krajów.

W 1979 r. suma lokat bezpośrednich w świecie szacowana była na 400 mld. dol.

Warto także dodać, że wartość produkcji takich lokat przekracza ich wysokość. Z reguły 2-3-krotnie. W Anglii np. ok. 1/4 produkcji znajduje się w rękach kapitału obcego, głównie USA. Wzajemne przenikanie się tu lokat bezpośrednich jest bardzo rozwinięte. Również USA są terenem ekspansji kapitału obcego, ostatnio zwłaszcza japońskiego. "Korporacje globalne" USA np. tylko w Europie Zachodniej planują zainwestować w 1981 r. ok. 24,2 mld. dol., w tym w Anglii i RFN po 3,7 mld. dol. w każdym, co nawet jak na takie kraje jest sumami znacznymi. W Australii przypływ kapitałów prywatnych w b.r. wyniesie 7,8 mld.dol.

Można nawet zaryzykować stwierdzenie, że dziś nie można zostać krajem wysokorozwiniętym w pełnej izolacji przed kapitałem obcym. Pewne wyjątki od tej reguły w przeszłości są niepowtarzalne. Poziom nauki i techniki, organizacji pracy, a przede wszystkim wymiany międzynarodowej jest już tego rodzaju, że zbyt kosztowne byłyby pewne "niezawisłe" założenia rozwojowe. "Współzależność rozwojowa" jest tu imperatywem samego rozwoju w ogóle, a podmiotami w tej współzależności są głównie wspomniane "korporacje globalne" wspomagane przez "banki globalne".

Jest to tym bardziej prawda, że ostatnio następuje i inny proces, a mianowicie coś na wzór "kartelizacji korporacji globalnych". Konkurencję zastępują one różnego rodzaju porozumieniami, zwłaszcza w dziedzinie współpracy naukowo-technicznej i podziału rynków. Tak np. realizuje się ideę budowy "samochodu światowego", gdzie wiele części i podzespołów byłoby wzajemnie wymienialnych bez względu na markę samochodu. Podobnych "światowych produktów" będzie zapewne więcej. Pozostawanie poza siecią takich producentów może de facto zamknąć drogę do rynku światowego.

Polska jako kraj przemysłowy i o decydującym udziale wyrobów przemysłowych w eksporcie - nie ma innego wyjścia w przyszłości niż szukanie ścisłych więzów z "korporacjami globalnymi". Jeśli tak, to pozostaje problem, jak to zrobić?

Przede wszystkim musimy przełamać "barierę psychologiczną" przed obcymi lokatami bezpośrednimi. Obawa przed oddaniem gospodarki pod kuratelę potężnych "korporacji globalnych" jest bardziej teoretyczna niż praktyczna. Ostatecznie lepiej wygląda zakład pracujący pod obcym szyldem niż rozpaprany w "zamrożonych" inwestycjach albo nie pracujący ze względu na braki surowcowe i inne...

Oczywiście, otwarcie gospodarki przed lokatami bezpośrednimi wymagałoby wielu zmian w systemie naszego gospodarowania /w kierunku szerokiego zastosowania mechanizmów rynkowych/ oraz w naszym prawodawstwie.

Są to jednak sprawy, których jako oczywiste nie poruszam w swoich Propozycjach.

Natomiast chodzi o samą zasadę, jak zacząć cały proces i jak go poprowadzić.

Otóż w naszej konkretnej sytuacji musielibyśmy na początek przyjąć zasadę, że obecne zadłużenie jesteśmy gotowi zamienić całkowicie lub częściowo na lokaty "korporacji globalnych", rzecz jasna za zgodą dotychczasowych wierzycieli /tj. rządów i banków handlowych/. Tzn. dotychczasowi wierzyciele odpożyczyliby swoje należności owym korporacjom.

Chodziłoby więc konkretnie o to, aby nie nastąpił możliwie żaden transfer części naszego dochodu narodowego w postaci spłat rat i procentów.

W zamian za to moglibyśmy dopuścić przewidziane do transferu sumy do wybranych dziedzin naszej gospodarki jako lokaty bezpośrednie "korporacji globalnych". Zainteresowane "korporacje globalne" przejęłyby więc odpowiednie sumy od dotychczasowych wierzycieli na warunkach uzgodnionych między nimi i przy pośrednim i bezpośrednim naszym udziale, co do kierunków inwestowania tych lokat.

Oczywiście negocjacje szczegółowe mogłyby tu być bardzo złożone, ale chodzi o otwarcie samej możliwości jako takiej.

Gdyby się to powiodło /teoretyczne szanse tu istnieją/, to wówczas de facto zmieniłby się profil naszego zadłużenia, a tym samym wyszlibyśmy z "pętli" sztywnych spłat rat i procentów. Zadłużenie byłoby bowiem związane z naszą gospodarką, jak to ma miejsce z lokatami bezpośrednimi w ogóle. Groziłby nam jedynie transfer zysków, ale te przedtem musiałyby w ogóle mieć miejsce /zapewne via eksport wolnodewizowy/. W przypadku powodzenia operacji mogłaby zaistnieć perspektywa reinwestycji zysków z lokat oraz napływ nowych kapitałów, a zatem nawet transfer zysków mógłby nie mieć ujemnego efektu dla naszego bilansu płatniczego.

Uważam, że powinniśmy dopuścić nawet możliwość istnienia tzw. filii 100-procentowych, tj. w całości będących własnością "korporacji globalnej" /np. filia Coca-Coli/. Nawet na zasadzie "enklawy" w naszej gospodarce, zwłaszcza jeśli dana filia miałaby wybitnie "eksportowy profil".

Jeśli tak byłoby, to sam poziom zadłużenia Polski przy zmienionym profilu stałby się problemem *trzeciorzędnym*. Mogłoby ono wzrastać do *dowolnej* wielkości. Nie byłoby tu bowiem *żadnych* sztywnych zobowiązań płatniczych. Transfer zysków, w przypadku trudności w bilansie płatniczym, możnaby regulować znanymi w świecie sposobami. Inne zaś transfery *nie mogłyby* nastąpić. Lokaty bowiem byłyby *związane* i przed transferem musiałyby ulec *sprzedaży* /z reguły lokalnie/, co zmienia całą postać rzeczy.

Krótko mówiąc, jest to *jedyne* wyjście nie tylko z "pętli zadłużenia", ale jednoczesnego *zaktywizowania* kapitału obcego w rozwoju Polski na wzór innych krajów. W ten sposób nie tylko korzystalibyśmy z zewnętrznych źródeł finansowania naszego rozwoju, ale jednocześnie rozwiązalibyśmy problem kłopotliwego oddłużania się /co nawet w "wydaniu Raportu" nie jest możliwe/.

IV/ *Uwagi końcowe*

Uważam, że tradycyjne metody rozwiązywania nowych problemów gospodarczych, do których zaliczam "klasyczny kredyt" i jego obsługę - *nie mają* już więcej szans powodzenia.

Trzeba więc sięgnąć do *niekonwencjonalnych* rozwiązań, gdzie zewnętrzne źródła finansowania będą odgrywać nadal jedną z decydujących ról w naszym rozwoju.

Polski po prostu *nie stać* ani teraz ani w przyszłości na luksus niekorzystania z zewnętrznych źródeł finansowania, ani tym bardziej na spłatę dotychczasowego zadłużenia w sposób tradycyjny.

Należy więc poszukiwać nowych alternatyw., którymi m.in. są prywatne lokaty bezpośrednie "korporacji globalnych".

Zdzisław Rurarz